

# BRIDGING TRUST DEFICIT

Enabling Ease of Running a Business in India



*Discussion Paper*

# **Bridging Trust Deficit**

## *Enabling Ease of Running a Business in India*

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*To bridge the trust deficit, the government needs to focus on reducing discretionary interactions and abuse of power by government officials, by revisiting legal provisions that bestow unfettered powers on government officials*

## Introduction

The government has laid significant emphasis on enabling ease of doing business (EoDB) in India. A closer review reveals that it is focusing on reducing and digitalising formal touchpoints between government officials and businesses. These are predominantly concentrated at the time of start of business, and periodic compliances prescribed by statutes. As a result, the intent seems to limit the scope of corruption and rent-seeking opportunities during issuance of approvals for initiation of business, and when approvals become due for renewal.

However, as this Discussion Paper shows, much corruption happens during interactions between government officials and businesses, that happen at the discretion of such officials. These include site visits, inspections, searches, notices for recovery of allegedly due amounts, and seizures of items belonging to businesses, among others. Such incidents shake the trust of businesses in the government and business environment and lead to unease in running a business in India.

This paper argues that to bridge the trust deficit, the government needs to focus on reducing such discretionary interactions and abuse of power by government officials, by revisiting legal provisions that bestow unfettered powers on government officials.

The deliberately ambiguous laws need to clearly define situations and processes for invoking such powers, substantive and procedural safeguards while exercising them, and accountability and deterrence mechanisms to prevent abuse.

To this end, existing and proposed business-facing laws need to be subject to a three-step test of legitimacy, suitability, and proportionality. Only provisions passing all the tests should be retained, while others would either need to be scrapped or amended.

## Government's Role in Ease of Running Business

The government is not only a rule maker and enforcer, but also acts as a counterparty for businesses in several transactions, and is also the largest litigator, thereby choking up the judiciary. To ensure real ease of running a business, the government needs to revisit how it transacts with the industry, particularly small and medium enterprises.

Technology can help in tracking receipt of goods and services from business, and automate payments, ensuring timeliness.

The government also needs to conduct a comprehensive cost-benefit analysis to decide on the initiation and continuation of litigation. It must better plan the use of public money, and prioritise alternative dispute resolution modes for contract enforcement.

*The Department for Promotion of Industry and Internal Trade (DPIIT) has also been working on reducing the compliance burden on businesses by simplifying, rationalising, digitising and decriminalising government-to-business interfaces*

The journey of ease of running a business must not end at enabling ease of starting a business but needs to go much beyond. In particular, tackling difficult areas like curbing officials' urge to extract rent from businesses, delay legitimate dues, and initiate litigation, will be crucial in this regard. Only then India will be able to achieve its dream of Viksit Bharat by 2047.

### **Government's Focus: Infusing Trust during Prescribed Interactions with Businesses**

The Government of India, under the leadership of Prime Minister Narendra Modi, has demonstrated significant commitment to improving EoDB in the country. The PM has called upon the country to respect wealth creators, which was to turn the general feeling in the country against businesses. Until now, we were influenced by our legacy of a socialist economy to think that big is bad and profit is a dirty word.

The idea of the current campaign by the government appears to reduce and digitise points of formal interactions between government officers and businesses, such as grants of licences, approvals, and authorisations, including the filing of tax returns. It is hoped that reducing such prescribed touchpoints will limit corruption and rent-seeking opportunities,

thereby inspiring trust and confidence among entrepreneurs to start and run their businesses smoothly. Evidence does show that corruption has come down.

As a result, during the past decade, India made considerable upward progress in now-defunct Doing Business Rankings (DBR) which the World Bank used to release. India ranked 63<sup>rd</sup> in the last DBR 2020, which was an impressive jump of 79 ranks within five years, as India's rank in 2014 was 142.

These rankings also inspired competition among states which were also compared on doing business indicators formulated by the government. States have been encouraged to focus on enabling investments, ensuring access to information and improving transparency, adopting an online single window system, reforming land allotment, facilitating construction permits, reforming labour regulation, and facilitating environment registration and utility permits.

The Department for Promotion of Industry and Internal Trade (DPIIT) has also been working on reducing the compliance burden on businesses by simplifying, rationalising, digitising and decriminalising government-to-business interfaces.<sup>1</sup>

To this end, a National Single Window System (NSWS) was soft-launched in 2021. It functions as a

*The Gatishakti programme and National Logistics Policy also aim to facilitate coordination between different ministries on specific issues to improve the business environment*

unified platform for applying all government-to-business clearances from various ministries/departments. The NSWS portal helps businesses identify relevant business approvals across 32 central departments and states/UTs. It also provides for a unified application system wherein common information, including documents, is collected once and auto-populated across forms and platforms.

Businesses are also able to check approval status across ministries and states through a single dashboard, make payments online, and digitally sign their documents.<sup>2</sup>

Essentially, the NSWS aims to create a transparent digital barrier between government officials and businesses for formal interactions, so that the possibility of corruption minimises during such processes.

The DPIIT has also released a guide on measurement and reduction of cost of doing business.<sup>3</sup> This measurement includes costs associated with fees, licensing and other statutory requirements, and opportunity costs owing to delays in decision-making by the government. It has been estimated that the average cost paid by a company to access 13 services for business purposes in a state was around ₹21 lakhs. Huge divergences were found across states and union territories, with costs in some states being as high as ₹50 lakhs, while in others, it could be close to ₹15 lakhs.<sup>4</sup>

The idea seems to nudge government officials to take decisions within a pre-determined time frame failing which the relevant approval is deemed to be provided to the business. However, such cost assessment exercise does not appear to consider informal and other costs incurred by businesses.

In her budget speech for 2022-23, the Finance Minister, Nirmala Sitharaman, highlighted that a significant reduction in compliance requirements, totalling over 25,000, was achieved in recent years, accompanied by the repeal of 1,486 union laws.<sup>5</sup>

In the 2024-25 interim budget as well, the government with the aim to improve taxpayer services proposed to withdraw some outstanding direct tax demands. This aligns with its goal of enhancing ease of living and ease of doing business operations. However, there are still a large number of unresolved direct tax claims. Some of these claims date back to 1962. They are yet to be verified, reconciled, or settled. These unresolved claims cause anxiety among honest taxpayers. They also hinder the processing of refunds for subsequent years.<sup>6</sup>

Another recent example is the Jan Vishwas law, which proposed the decriminalisation of 183 provisions from 42 union laws, falling under the administration of 19 ministries.<sup>7</sup> As a result, several formal interaction touchpoints between



government officials and businesses are being eliminated, encouraging potential entrepreneurs to start a business.

The Gatishakti programme and National Logistics Policy also aim to facilitate coordination between different ministries on specific issues to improve the business environment. As a result, the World Bank's Logistics Performance Index 2023 ranked India at 38<sup>th</sup> position (out of 139 economies), recording an impressive improvement of six positions.<sup>8</sup>

The government has also launched the Indian Customs EODB Dashboard to promote transparency in export and import procedures,<sup>9</sup> thereby reducing the formal compliance burden on businesses.

As a testimony to the government's focus on enabling ease of starting a business, more than 1.96 lakh companies and limited liability partnerships have been incorporated in the country between January and November 2023, much higher than in previous years. Similarly, more than three crore Micro Small and Medium-sized Enterprises (MSMEs) were registered in India between July 2020 and November 2023.<sup>10</sup> The government continues to focus on bolstering 'ease of compliance' and 'ease of starting a business.'

However, judicial delays remain a big hurdle and cannot be resolved by the government because it is

not under their control. The independent judiciary has been nudged many a time but it moves at its own snail's pace.

## Trust Deficit during Discretionary Interactions between Government and Businesses

### Unrestrained Powers with Government Officials

While the aim to minimise instances of formal interactions and touch points between government officials and businesses is necessary, it is not sufficient to enhance and sustain the trust of businesses and entrepreneurs in the country's business environment. Formal touchpoints between government officials and businesses are few and far between and are mostly concentrated at the time of starting a business.

On the other hand, the significant scope of discretionary interactions between government officials and businesses exists during the running of business.

This is because the country's regulatory framework, comprising myriad laws, rules, regulations, and practices provides immense powers and unrestrained discretion to government officials across all levels to create discretionary interaction opportunities with businesses, who act according to their whims, and extract rents.

*The government has also launched the Indian Customs EODB Dashboard to promote transparency in export and import procedures*



*It also needs to be noted that tax officials are not the only ones at fault for such an unending zeal to extract revenues from businesses. Their incentives and informal diktats from superiors (flowing right from the top) to generate as much revenue as possible for the government result in such creative interpretation and eventually make it more difficult to run businesses*

Such interaction opportunities are created by way of unreasonable interpretation of regulatory provisions, surprise checks, inspections, unwarranted summons of records and documents, unplanned searches of business premises, undocumented seizures and confiscations of items belonging to businesses, demands for fees, taxes, penalties, which are often retrospective, and other means.

An example of this is the imposition of retrospective taxation. This worked as an obstruction to the ease of running a business and was quite evident from the litigation between Vodafone and the Government of India. Many Indian and foreign industries considered this as tax terrorism.<sup>11</sup>

The poorly formulated and strict GST tax system has hindered efforts to streamline business operations. It redirects resources towards resolving time-consuming and expensive long-standing issues, as GST laws do not offer a mechanism for resolving disputes outside of court, unlike income tax regulations.<sup>12</sup>

More recently, the government issued notices demanding angel tax from more than 2,000 startups which had raised money during the past decade, on suspicion of round-tripping and inflated valuations. The notices were mostly sent to the startups whose

valuations had fallen after the first round of fundraising, despite the government's active promotion of India as a start-up nation (including Start Up as a new track in the G20 India process) and global recognition that start-up valuations are mostly based on potential future performance and subject to significant fluctuations.

No official data has been maintained on several start-ups impacted by such demand for angel tax.<sup>13</sup> Such inconsistent approaches by different arms of the government add fuel to the unease of running businesses.

During 2022-23, the Goods and Service Tax (GST) authorities issued demand notices to companies spanning a range of sectors, such as consumer durables, smartphones, insurance, online gaming, and other service providers. The notices seem to largely pertain to the initial period after a shift to the GST regime, a time marked by considerable uncertainty and teething problems.

Businesses have been concerned with the multiplicity of notices, absence of uniform processes, lack of coordination between the central and state tax authorities, and significant powers with the officers which led to such notices. While it's nobody's case that firms should not pay their fair share of taxes, unfettered discretion with authorities which results in creative interpretation of provisions, and

issuance of such unreasonable notices for years gone by, needs to be curbed.<sup>14</sup>

It also needs to be noted that tax officials are not the only ones at fault for such an unending zeal to extract revenues from businesses. Their incentives and informal diktats from superiors (flowing right from the top) to generate as much revenue as possible for the government result in such creative interpretation and eventually make it more difficult to run businesses. As a result, entrepreneurs need to spend more time and resources with consultants, lawyers, and accountants, rather than focusing on innovation and job creation.<sup>15</sup>

Laws often empower government officials to act 'as per they deem fit', or 'in the public interest', or for protection of 'public order', or to uphold 'safety or security of the state', or uphold 'in the interest of sovereignty or integrity of India', or to maintain 'friendly relations with other states', or to protect 'decency or morality', or to 'prevent any offence'. Such terms are capable of wide interpretation and allow considerable unquestionable freedom at the hands of government officials.

For instance, recently, Yogita Raghuvanshi, India's first female truck driver, bravely exposed corruption and harassment among drivers in front of government logistics officials. Roadside harassment by RTOs continues despite check-post removal,

causing long waits and extortion fears.<sup>16</sup>

This creates an atmosphere of inconvenience and fear among transporters which affects the overall ease of running a business. Similarly, despite the repeal of Section 66A of the Information Technology Act, the police continued to register FIRs under this provision creating an environment of suspicion among online entrepreneurs and users.<sup>17</sup>

These laws are relics of a colonial mindset wherein the relationship between government officials and the citizens was that of oppressor and oppressed. Unfortunately, even after several decades of independence, government officials refuse to shed this approach and often believe that they are acting in the national interest while behaving in the manner they do. They forget that the compact between citizens and the state has changed since independence, and the government has been elected and empowered by the people to act in the citizens' best interest.

Soon after independence, while we gave a new Constitution to ourselves to redefine the relationship between the state and individual, our failure to rewrite other laws and regulations, free them of the colonial mindset, and enshrined in the rule of law principles has resulted in a state of mistrust between the government and citizens, including businesses. The fact that for decades after

*Yogita Raghuvanshi, India's pioneering female trucker, courageously revealed corruption and harassment issues to government logistics officials. Ongoing roadside RTO harassment persists, despite checkpost removal, leading to long waits and extortion concerns*

*Several laws provide immunity to public servants when they act in 'good faith' while discharging their functions under such legislation*

independence, businesses were viewed with suspicion, profit was considered a bad word, and license raj was the order of the day. It did not help but seep this mistrust and dictatorial attitude of the government officials which benefitted a few.

### **Inadequate Accountability Mechanisms**

Inadequate accountability mechanisms and an overburdened judiciary do not come to aid businesses that are at the mercy of officials without any respite. Government officials are free to devise their procedures while acting as such and are not bound by rules of substantive or administrative law, or principles of natural justice. Several laws especially carved out exceptions from the Code of Civil Procedure, 1908, for officers to practice procedures they desire.

The executive is also empowered to issue a host of instruments such as rules, guidelines, regulations, directions, and circulars among others, to carry out their will. These instruments are not subject to sufficient checks and balances and thus act as legislative writ without actually being so. Sometimes, regulations are issued beyond the scope of the main act.

Actions of government officers are either shielded from judicial scrutiny or initiating judicial review of such actions is made considerably difficult by the parent laws. For instance, several laws

provide immunity to public servants when they act in 'good faith' while discharging their functions under such legislation. Like other terms discussed earlier, 'good faith' also has a considerably wide scope, thus practically providing a protective shield to government officers.

Moreover, Section 17A of the Prevention of Corruption Act necessitates departmental head approval for the Anti-Corruption Bureau to investigate officers, leaving some cases unresolved. More often than not, the approval remains pending because of the favours of the department heads, or inertia in the system.

Notable instances like Alwar collector Nannumal Pahadia's case highlight this issue, where prosecution sanction is pending even after retirement. Numerous officers, including IAS Neeraj K. Pawan and IPS Manish Agarwal, faced similar charges. They have been sentenced to jail, under various cases of corruption, however, the government has given them postings despite criminal charges.<sup>18</sup>

The Anti-Corruption Bureau of Rajasthan has received 556 credible complaints with evidence of public servants' corruption. Officials flagged 514 cases for investigation, but they await department head approvals, causing delays and disillusionment among citizens, including businesses.

*In India and other countries in which corruption is systemic and socially accepted, it is imperative to move anti-corruption policies away from their present fixation with strict monitoring to strict punishment. Monitoring alone without severe punishment is not sufficient. Corruption cases ought to have swift trials and a better rate of conviction*

Moreover, once a complaint is filed, the whole establishment typically 'blacklists' the protesting entrepreneur whose life becomes more difficult. Therefore, many entrepreneurs pay up the extortion money and keep quiet. Naturally, the money gets adjusted in the cost and the pricing of the outputs, adversely impacting consumers.<sup>19</sup>

The recently adopted criminal laws made some progress in this regard by providing for deemed approval for the prosecution of senior government officers after 120 days if no rejection is made by relevant departmental heads.<sup>20</sup>

However, the laws also bring terrorism, corruption and organised crime under the ambit of ordinary criminal law. These aspects have been reserved for stringent special legislation since they upend the general protections by reversing the burden of proof on the accused to restrict bail. Inconsistencies between specific and general laws may make prosecution of erring government officers difficult.<sup>21</sup>

Interestingly, in a recent study, a novel attempt was made to analyse how the select candidates aspiring to join the highly competitive elite civil services in India respond to experimental bribery situations. These situations were administered to examine the impact of varying degrees of "punishment," "monitoring," and "public loss" and their relation to the varying "bribery amount." The findings

suggest that high public loss and severity of punishment were able to deter bribery when the bribe was high.

On the other hand, the impact of a high level of monitoring was only effective in cases where the bribe was low. The study suggests that in India and other countries in which corruption is systemic and socially accepted, it is imperative to move anti-corruption policies away from their present fixation with strict monitoring to strict punishment. Monitoring alone without severe punishment is not sufficient. Corruption cases ought to have swift trials and a better rate of conviction.<sup>22</sup> Much ground needs to be covered in these areas.

Thus immunity without accountability, government officials often extract rent and make running of business in India considerably difficult. The government has not been able to focus as yet on reducing the nuisance value of bureaucrats who feel it is their birthright to demand a cut from an entrepreneur who is doing genuine operations. This is compounded by the problem of inviting more trouble if a complaint is lodged.

During 2022, the Central Vigilance Commission (CVC) received more than 1.15 lakh corruption complaints against all category employees of the central government. Of these, CVC claims to have disposed of around 85,000 complaints.<sup>23</sup> There seems to be no procedure to examine the

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effectiveness of the complaint resolution process and whether complaints are being resolved to the satisfaction of the aggrieved entity.

As per the National Crime Records Bureau, in 2022, more than 11,142 corruption cases were pending investigation. Furthermore, the conviction rate in corruption cases is also abysmally low. A total of 4,993 people were arrested under the Prevention of Corruption Act. Of these, only 852 were convicted, and departmental action was taken against a mere 445.<sup>24</sup> Such a low conviction rate emboldens officers to continue to indulge in corrupt practices, without any fear.

In addition, there have been concerns about pliant officers being appointed to head bodies set up for checking government corruption. Such capture gradually leads to a decline in institutional quality, resulting in turning a blind eye to instances of corruption. For instance, the total number of reports from the Comptroller and Auditor General (CAG) relating to central ministries and departments gradually came down from 55 in 2015 to 14 in 2020, a fall of 75 percent.<sup>25</sup>

When guardians of probity in public life shun their responsibility, economic downfall becomes a surety. Cases of enforcement officers taking bribes to close investigations against corrupt officers have also been reported frequently.

It is not that attempts have not been made to strengthen the institutional framework to check corruption. However, most such attempts have unfortunately not met with the desired success. For instance, the Lokpal and Lokayuktas Acts were expected to be a potent tool against corruption. The shape that the final legislation took was inadequate in ensuring that the Lokpal and Lokayukta could realise their intended status as the defenders of democracy and accountability in the Indian state.

Scholars have also recommended the creation of an independent commission against corruption to act as a watchdog for ensuring that corruption does not become a hindrance to development and that the resources of the state are distributed fairly and equitably.<sup>26</sup> However, all these recommendations have failed to see the light of the day.

Furthermore, several expert committees such as the Second Administrative Reforms Commission and Hota Committee on Civil Service Reforms have noted a lack of customer-centricity in the functioning of government officials. They have recommended a host of reforms to address this challenge.

However, the situation on the ground appears to have not improved much. Small entrepreneurs with no connections in the government corridors continue to remain at the receiving end of government apathy.

*The Global Corruption Barometer-Asia found India at 39 percent for overall bribery and 46 percent for personal connections in obtaining services*

For instance, at times, when a business is required to upload a picture on the form, it has to go through a tortuous process of obtaining the picture in the right format and adjusting it to the appropriate size. While this may not be too difficult for an established urban business, it can become a nightmare for a small rural entrepreneur.<sup>27</sup>

In September 2020, the government launched Mission Karmayogi, with an endeavour to prepare Indian civil servants for the future by making them more creative, constructive, proactive, professional, progressive, enabling, and transparent. The mission also called for a citizen-centric approach, requiring government officials to have respectful interactions, and problem-solving competencies and to undergo an attitudinal change.

However, reports suggest that Mission Karmayogi has not yet taken off, as there has been no impetus in the training of civil servants, and in many cases, the right person is not in the right position.<sup>28</sup>

Unsurprisingly, the conveniently ambiguous regulatory framework and the business having no option but to comply and pay bribes gives rise to the politician-bureaucrat-business nexus of corruption. Transparency International's recent survey reveals India's alarming bribery rates, which are the highest in Asia. The Global Corruption

Barometer-Asia found India at 39 percent for overall bribery and 46 percent for personal connections in obtaining services among the worst performing countries.

While some discretion with government officials is necessary to deal with emergencies and novel situations, there is a need to prevent abuse of discretion to restore and uphold the trust of businesses in government. This can happen if rule of law principles are incorporated in the laws which enable government officials to invoke discretion with due care and such officials are held to account in case of abuse of powers.

## **Trust Deficit in Additional Roles of Government: Counterparty and Litigator**

### **Government as a Counterparty**

Rule-making and enforcement are just some of the roles which government plays *vis-à-vis* businesses. It is often counterparty to a variety of businesses and procures goods and services from them. Procurement from local small-scale manufacturers and suppliers is often mandated under laws to promote domestic manufacturing.

Typically, such public procurement happens through a centralised online portal and in accordance with rules laid down by the government from time to time.



However, more often than not, eligibility criteria for procurement are designed in a way that only a few traditional firms can qualify. Such exclusionary conditions are agreed between government officials who are in cahoots with established businesses and receive a cut from them, which often is a fixed percentage of the contract value. If not money, other favours include expenses paid trips, sponsored admission of wards to foreign universities etc etc.

When smaller competitors attempt to challenge these conditions, they are left disappointed as such conditions are termed as 'policy decisions' beyond judicial scrutiny and deemed essential to ensure that public money is spent on tried and tested suppliers with recognised quality and timely delivery. The fact that competition and innovation are distorted through this approach promotion of which could be a judicious use of public money does not even occur to officials.

Even when smaller and newer businesses can land government contracts, they are made to run from pillar to post to get paid for the products and services they supply to the government. Timely payments are essential to keep these businesses running as they have limited operating capital and rely on receivables from the government to pay their vendors and manage routine affairs.

Unfortunately, government procedures prescribe multiple sign-offs and signatures from officers across levels for making payments to outside agencies, which are difficult to extract without making a *chadhawa* or offering to them or just doing several *hazris* which satisfy their petty egos.

Across all construction contracts in government departments throughout the country there is an unwritten rule of paying a percentage of the bills at all levels, which often results in poor quality. This is over and above the initial payoffs to politicians to procure the contract. This ability of the ecosystem to extract rent irrespective of their engagement with businesses is rooted in the conveniently ambiguous laws that fail to hold them to account, as discussed previously. If an enquiry on just disproportionate assets is done on retired engineers and politicians it would show the magnitude of ill-gotten wealth and how it added to the cost of construction etc.

It appears that the government has been working on a 'delaying' reform to streamline the movement of files in ministries and departments, to ensure that the number of levels through which a file moves should not be more than four. In addition, financial powers are being delegated to joint secretaries, under which the relevant officers can make decisions on a project or a specific

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*In Rajasthan, in the recent past, there have been instances of the government issuing notices to businesses for recovery of fire, urban development, and other cess and taxes. Many of these demands have been issued from retrospective effect, for the past 10-15 years, despite several units having been set up in the past 5-7 years*

programme instead of waiting for the project or the file to be cleared. Several ministries and departments have filed self-assessment forms, reporting compliance.<sup>29</sup>

However, real change can only be felt by businesses interacting with government officers, and their impartial feedback needs to be taken by the government to gauge the effectiveness of such steps. After all, the 'consumer' or 'recipient' of the services from the government should determine whether business has become easy.<sup>30</sup>

Government and government-owned agencies not only receive goods and services from businesses but also often supply them. For instance, state-owned banks provide loans and credit to small businesses at attractive rates to further the government's agenda of financial inclusion. However, there are instances of replete of such bank officials asking for a cut in return for approving and/or disbursing a loan to hopeful borrowers.

Similarly, government or government-owned agencies supply key utilities such as water, electricity, and municipal services, among others to businesses. In return, they charge fees and cess from businesses. In Rajasthan, in the recent past, there have been instances of the government issuing notices to businesses for recovery of fire, urban

development, and other cess and taxes. Many of these demands have been issued from retrospective effect, for the past 10-15 years, despite several units having been set up in the past 5-7 years.<sup>31</sup>

Such experiences demotivate entrepreneurs, particularly women entrepreneurs who have to face additional gender-related discrimination while running their businesses.

### **Government as a Litigator**

Last but not least, the government is also one of the biggest litigators, accounting for nearly half the pending cases. In early 2022, the then Chief Justice of India opined that the executive could tackle the piling litigation by dealing efficiently with disputes relating to its departments and state-owned entities.<sup>32</sup>

Similarly, while the government has leveraged Goods and Service Tax (GST) reform to showcase its success on ease of doing business front, a tribunal to adjudicate disputes arising from the GST law was notified only in 2023, six years after GST legislation was introduced in 2017.

As of September 2023, the government notified the establishment of 31 benches of the GST appellate tribunal in 28 states. However, the tribunals are yet to function. Not notifying the GST tribunals led to a flurry of litigations in high courts. According

*Corruption has a corrosive impact on a country's economic growth. Corruption significantly increases the likelihood of small and medium manufacturing enterprises being financially constrained*

to a parliamentary response from March 2023, the ministry is fighting over 1.5 lakh such cases across India.<sup>33</sup>

The judiciary has also often called out the government's dichotomous approach in blaming courts for restricting 'ease of doing business' despite being the biggest litigant and seeking needless adjournments repeatedly.<sup>34</sup> It has also pointed out that issues which should ideally be decided by central and state governments are not being addressed and everything is being left to the courts to decide. These span issues like dog menace, pollution, and same-sex marriages, all of which should ideally be dealt with by the administration and legislature.<sup>35</sup>

The refusal to resolve disputes at the table, the arrogance of government officials being always right, and the resources to fund a lengthy trial, make the government the perfect litigator. Unfortunately, businesses do not have such luxuries and have to make ends meet, forcing them to agree to terms of settlement offered by government officials, which often include informal payments or favours to them or their near and dear ones.

## Impact of Trust Deficit

Trust deficit between government and businesses gives rise to the uncertain and unpredictable business environment in the country which discourages

investments and expansion by businesses. The opportunity cost of keeping cut money ready at all times and paying regularly, which should have ideally gone into business or related activities, is huge.

A recent study estimates the impact of bureaucratic corruption on access to finance for small and medium enterprises in the manufacturing sectors of 79 developing countries. It suggests that corruption can make it difficult for businesses to obtain financing by reducing profits, increasing credit demand, increasing the likelihood of bankruptcy, creating uncertainty about future profits, and exacerbating the asymmetric information problem between borrowers and lenders.

Consequently, corruption significantly increases the likelihood of a small and medium manufacturing enterprise being financially constrained. The study estimates that one standard deviation increase in the prevalence of corruption leads to a 3.5-4.9 percent increase in the likelihood or probability of SME manufacturing being financially constrained.<sup>36</sup>

Corruption has a corrosive impact on a country's economic growth. Studies indicate that corruption disproportionately affects entities engaged in innovative activities because innovators need government-provided goods more than ordinary producers. Therefore, they become primary

*Close to 14,000 MSMEs have withdrawn their registration from the government in the calendar year 2023, perhaps owing to corruption and other challenges*

targets of corruption. In addition, innovators usually do not have the resources (as they need extensive funding) for their investments, making them vulnerable to corruption.

As a result, their skills and efforts are directed to corrupt processes rather than productive investments.<sup>37</sup> It is thus no surprise that India is yet to witness a truly global innovative enterprise. Corruption appears to be the key hindrance in this regard.

Corruption and bribery also provide access to typical public services like certifications, public services, electricity connections, licences, police aid, and medical care, and prevent unnecessary scrutiny of business operations, inspections and investigations, and searches, among other things which are inconvenient for businesses.<sup>38</sup> This creates an uneven playing field between those who are able and willing to make informal payments and those who are not.

More often than not, small businesses are unable to meet the bribery demands of government officials and are at the receiving end of their wrath, making their already vulnerable situation worse. The pervasiveness of corruption across all levels of the administration has been acknowledged by constitutional courts as well.<sup>39</sup>

Close to 14,000 MSMEs have withdrawn their registration from the government in the calendar year 2023, perhaps owing to corruption and other challenges.<sup>40</sup> The public perception of the existence of corruption is quite high and so is the assumption of the politician-bureaucracy-business-criminal nexus which benefits from it. Unfortunately, the citizens have accepted it as a way of life and the only way to get things done in the country.<sup>41</sup>

## Bridging the Trust Deficit

### Limiting Discretionary Interaction Opportunities and Compliance With Rule of Law Principles

Over decades, several attempts have been made to contain the epidemic of corruption and bridge the trust deficit that businesses have in government officers. However, most of these appear to be reactive, i.e. focus on monitoring and prosecution, and do not target the root cause of the problem i.e. archaic laws with unchecked powers and limited accountability with government officers.

A multi-pronged approach focusing on transparency, deterrence and accountability would be essential to make a dent in the menace of corruption during discretionary interactions between government and businesses and improve the ease of running a business in India.

While the repeal of some archaic laws contains the problem of stock of bad laws to some extent, it does not impact the regular flow of new laws and amendments to older ones providing similar unrestrained powers to government officers. Several legislations proposed and enacted in recent times have incorporated provisions aiming to give significant powers to the executive, without concurrent principles to guide the exercise of such powers, or accountability mechanisms to prevent misuse.

This trend is increasingly evident in laws related to the internet economy, like the Telecommunications Act, Broadcasting Bill, and rules framed under the Information Technology laws, among others. The new criminal laws also accord significant powers to the police and investigation agencies, without necessary checks and balances.

Thus, it would be crucial to ensure that government officers are empowered with only such powers which are essential to achieve legitimate policy objectives of the government. Ambiguity by design should be avoided and principles of plain and simple drafting techniques should be adopted<sup>42</sup> so that even a normal entrepreneur can understand the letter of the law. Terms like 'public interest', 'public order', and 'safety and security' should be avoided and clearly defined with limited scope wherever they cannot be done away with.

Laws empowering government officers should also come with a sunset clause so that such provisions are automatically scrapped once the policy objectives are met, within a pre-determined period. Continuation of such provisions in laws must require proper justification from the government and scrutiny by lawmakers on the costs and benefits of such provisions on businesses and citizens.

The protection available to government officers for actions supposedly undertaken in good faith and immunity from judicial review also needs to be revisited with well-defined safeguards. A blanket exemption does not suit the times and disproportionately empowers government officers. Instead, carefully drafted case-by-case exceptions which limit the potential of misuse need to be designed. The scope of good faith also needs to be laid with the burden of proof on the relevant government official and not the citizen or the business. This is a difficult task but is need of the hour.

Also, laws should lay down substantive and procedural safeguards to be followed to prevent misuse and incorporate rule of law indicators such as sufficient prior notice, an appropriate opportunity to respond and be heard, disclosure of material forming the basis of government action and ability to dispute the same, time-bound reasoned orders, ability to appeal,

*Laws should lay down substantive and procedural safeguards to be followed to prevent misuse and incorporate rule of law indicators*

among others. The importance of such safeguards was recently highlighted by the Bombay High Court in Kunal Kamra v/s. Union of India and connected matters.<sup>43</sup>

The burden of proof should lie with government officers to justify invoking powers like inspection, investigation, search, seizure, and confiscation, which should be the exception and not the rule. Notices of recovery of taxes, fees, and cess, should be issued with adequate reasoning and approval of sufficiently senior officers.

The greater the time gap between the date of notice and the period it relates to, the threshold for approval of issuance of notice should be stringent, and the reasoning should be stronger. Such notices should come with appropriate justification for delays and costs could be imposed on government officers if these are found without substance. These reforms are essential to avoid the process becoming punishment for businesses, who might be eventually left off the hook by government officers but are scarred by the harassment they have to endure in the name of procedural requirements.

Non-compliance with such rule of law principles must invite penalties that the erring government officer should be obliged to pay from his pocket, along with disincentives like demotion or reduction in pay. To hold government officers to account, the doctrine of 'public

accountability' and 'equal fault' could be invoked. It is based on the premise that the power in the hands of administrative authorities is a public trust which must be exercised in the best interest of the people.

All this needs to be hard-wired into the laws as mere issuance of guidelines and codes of practice is unlikely to have the desired impact of correcting the behaviour of government officers towards businesses and/or citizens. Such clarity of legislative intent will act as a deterrence and also aid judicial authorities inappropriately interpreting legal provisions, with a citizen-centric approach that avoids the overboard interpretation of the executive's powers and prevents abuse.

The Supreme Court has laid down a four-step test of legitimacy, suitability, necessity, and proportionality for a government action to fit within the exception of 'reasonable restrictions' for infringing fundamental rights of citizens.<sup>44</sup>

Given that the right to practice a business or profession is a fundamental right recognised under the Constitution, inspiration should be taken from the principles laid down by the Supreme Court to impose restrictions in the law on government officers from creating unreasonable discretionary interaction opportunities with businesses, violate their right to freely run their business, and indulge in corrupt practices.

*The Supreme Court has laid down a four-step test of legitimacy, suitability, necessity, and proportionality for a government action to fit within the exception of 'reasonable restrictions' for infringing fundamental rights of citizens*

These principles are similar to the globally recognised framework of Regulatory Guillotine to reform regulation. It tests laws, regulations, and other government instruments on the parameters of legality, necessity and proportionality, in a consequential manner.<sup>45</sup>

Only such instruments which pass all three tests are retained, while others are scrapped or redesigned (for retesting). This test can be applied to existing as well as proposed laws and regulations and thus can be used to address the concerns regarding the existence and introduction of bad laws and regulations.

Robust public consultation and assessment of costs and benefits of legal provisions on all stakeholders, especially businesses (through the adoption of tools like Business Regulatory Impact Analysis), could be institutionalised to efficiently implement the Regulatory Guillotine framework. The lack of transparency in framing laws can lead to bad law-making as it does not consider multi-stakeholder views before adoption.

Unfortunately, the non-compliance with government's pre-legislative consultation policy has been a feature of government functioning and not a bug, as of the last 300 bills introduced in the Parliament, 227 were proposed without complying with provisions of the policy.<sup>46</sup> This needs to change and pre-legislative consultation be

made mandatory, except in the case of ordinances. Recently, Ministry of Corporate Affairs adopted a pre-legislative consultation policy. Other departments must also design and adopt similar policies.<sup>47</sup>

### **Ensuring Timely Payments to Businesses**

Technology could come to the rescue to prevent delayed payments to firms dealing with businesses. Smart contracts and distributor ledger technology could help track compliance and completion of conditions necessary for the release of payments. When conditions attached to a milestone are met, automatic instructions could be relayed to the system for releasing due instalments.

While technology can track the delivery of goods and services, government officers will be in a position to indicate if the desired quality parameters are met. In case of an illogical response by such officers within a prescribed timeframe, quality should be deemed to have been met and payments should be released automatically.

Moreover, such government officers should be required to provide detailed explanations of delays in decision-making. Any delayed payments to businesses must be accompanied with interest, to be recovered from the compensation due to the government officer responsible for unreasonable delay.



*Technology-enabled process flows need to be built to ensure timely payments to businesses, and the capacity to conduct cost-benefit of invoking and continuing litigation would also need to be created within the government*

When government departments and state-owned entities provide service to businesses, they should act at arms-length from their role as regulators and enforcers of policies. Businesses should be able to raise concerns regarding delay in delivery, and sub-optimal quality of services, and negotiate the cost independently on how they would be treated by the regulatory arm of the government. Only then will businesses be able to freely transact with government departments and state-owned entities.

### **Making Litigation Difficult for the Government**

Given that government-initiated litigation is the key reason for clogging the judiciary and making contract enforcement difficult, litigation needs to be made difficult for the government. Before initiating litigation, relevant government officers should be required to provide a detailed explanation of why litigation is necessary, how the matter reached a stage wherein litigation became inevitable, and why alternative mechanisms to resolve the dispute have failed.

Moreover, a detailed cost-benefit analysis of pursuing litigation and comparing the same with the costs and benefits of settling the matters outside of courts needs to be made compulsory. The decision to pursue litigation needs to be taken by sufficiently senior officials and its continuation needs to be reviewed periodically. At any time, if the costs of litigation exceed its

benefits or the net benefits of alternative dispute resolution mechanisms, litigation should be automatically dropped.

## **Way Forward**

Reducing opportunities for informal and discretionary interactions between government officers and businesses, forcing government officers to comply with rule of law requirements, automating payments to businesses, and making litigation difficult for government can go a long way in bridging the trust deficit and improving the ease of running a business in India.

To this end, there is a need to create a clear action plan to identify all legal and regulatory provisions that bestow discretionary powers to government officials vis-à-vis businesses, subject them to a three-step test of legality, necessity, and proportionality, and build in procedural and substantial safeguards for officials to invoke and exercise discretion.

Technology-enabled process flows need to be built to ensure timely payments to businesses, and the capacity to conduct cost-benefit of invoking and continuing litigation would also need to be created within the government. Several competent external institutions should be able to support the government in this endeavour and enable ease of running of business, to achieve the dream of Viksit Bharat by 2047.



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