

Opinion

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REDUCTION IN NPA LEVELS
Shaktikanta Das, RBI Governor

Our both Financial Stability Report and Trends & Progress in Indian Banking Report have given out figures and there is definitely an improvement noticed in the reduction of the NPA levels of banks as a whole and public sector in particular



Rational Expectations

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More quota-bait as elections in the air

Instead of winding down quotas, BJP raises them to target 55mn households; so less space for the truly meritorious to make it

GIVEN THE RSS view on reservations, many believed that once Narendra Modi came to power, the BJP would start unwinding the reservation genie that has not only deepened the caste divide, but is mostly responsible for the deterioration in quality of both education as well as government services; more important, this fitted in with Modi's reputation as someone who was primarily focused on development. Yet, with all parties playing caste politics, and RSS chief Mohan Bhagwat's anti-reservations comment costing the BJP the Bihar elections in 2015, the RSS too fell in line and the BJP went about increasing its appeal to various caste groups in the same manner that the Congress party or other caste-based parties like the SP and the BSP did.

So, the party pandered to powerful castes like Jats in Haryana and Marathas in Maharashtra. It was bad enough that, after various commissions ruled that powerful Marathas couldn't possibly be considered backward, the BJP managed to get the Maharashtra State Backward Class Commission to classify them as socio-economically backward—the same commission had, in 2008, said the Marathas were economically and politically a forward caste and even the Mandal Commission had classified Marathas as a forward caste.

To add insult to injury, the BJP is not carving out the 16% Maratha quota from the OBC quota—this would make other OBC groups vote against the BJP—but is creating a separate quota; whether this will pass judicial scrutiny remains to be seen, but once mainline political parties pander to this, it is clear India is not going to roll back reservations anytime soon. Indeed, this violates the 50% cap on reservations put by the landmark *Indra Sawhney* judgment, so the government will have to do some pretty fancy footwork to make this pass. The preferred means of doing this in the past was by putting such legislation under the Ninth Schedule that was out of the courts' purview, but in the *IR Coelho* ruling, the Supreme Court introduced the possibility of reviewing Ninth Schedule laws if they violated the Constitutional provision on fundamental rights.

Though, at one level, it was fair since OBC quotas are being cornered by powerful caste groups like the Yadavs, Modi is trying to create sub-quotas within the OBC category for the more backward. In Uttar Pradesh, the Justice Raghendra Kumar panel has suggested that just a fourth of the OBC quota should be kept for powerful groups like Yadavs and Kurmis. It remains to be seen if they will accept this reduction in quotas lying down or whether this will set off another round of violence of the type seen during the days when VP Singh introduced the Mandal reservations.

And now, the government has cleared a 10% quota for the economically backward among upper castes, over and above the 50% cap on that for SC/ST/OBC groups. This segment, data from the PRICE income survey of 2016, has around 55 million households and is, therefore, a large vote bank; upper castes are a traditional BJP vote bank and Monday's move will gladden their hearts.

At one level, it will be argued that, unlike the current reservation that is based on caste, this is a step forward since it is based on economic criterion, but that would apply if existing reservation was also changed to economic one—the BJP remains steadfastly opposed to introducing a 'creamy layer' criterion for SC/ST; indeed, it is pushing for reservation in even promotions.

Equally important, while the 50% ceiling came from the *Indra Sawhney* ruling, the Cabinet deciding to bring in a constitutional amendment means the principle has been overturned and the power now rests with Parliament—once this is done, any other government, including the BJP, can raise this at will. At another level, the 50% cap meant that merit would at least get half a chance at the best education and jobs; this *lakshman rekha* has now been crossed.

While the government and the BJP will justify their decision by arguing that the poorer upper castes weren't getting a fair deal and felt left out, it was bad government policy that led to this demand; so logically, good government policy would have helped re-bottle this genie. Even today, though a little less so, government policy actively discourages top-class educational institutions from coming up in the private sector; in the event, with a limited number of good educational institutions available, the demand for caste-based reservations grew stronger; for all its promises, the Modi government has been slow to relax this government chokehold.

The clamour for government jobs, and a reservation within this, has grown because of the fact that such jobs pay 2-3 times what the private sector does at the lower- to mid-level, and with virtually no obligation to perform. With this difficult to fix, and with private sector jobs not growing fast either, the government has in fact argued for quotas in even promotions in government jobs. Anyone looking for a winding down of reservations has to be quite disappointed since this decision makes it likely that reservations aren't going away in a hurry, indeed they are likely to keep increasing.

Deepening Divides

Telangana lawmaker's decision to boycott swearing-in in presence of Speaker from rival party sets a dangerous precedent

WHEN POLITICAL DIFFERENCES are made polarising and toxic, the eventual casualty is democracy. T Raja Singh, a BJP MLA from Telangana, has now refused to take oath in the presence of the state Assembly's pro-tem speaker, Mumtaz Ahmed Khan, who belongs to a rival party. Singh has dubbed Khan's party, All India Majlis-e-Ittehadul Muslimeen (AIMIM) "anti-Hindu". Singh may have bones to pick with AIMIM's politics, but politicising the institution of the Speaker in such a virulent manner, who is constitutionally bound to rise above party politics, not only sets a dangerous precedent but also weakens the office and, by extension, the Constitution itself.

Singh should keep in mind that, rightly or wrongly, the BJP is seen by many—and not just rival parties but also commoners—as "anti-Muslim". If every lawmaker owing allegiance to rival parties were to take a stand similar to his, governance in 16 NDA-ruled states could get affected severely, if not come to a complete standstill. Singh's other points of difference with AIMIM, as per a *Times of India* report, is that the party refuses to raise the *Bharat Mata ki Jai* slogan/salutation. But, such a narrow view of patriotism is what has led to entrenched communal polarisation. If a Muslim citizen of India says *Hindustan Zindabad* or *Jai Hind* instead of *Bharat Mata ki Jai*, does that make her less Indian or invested in the idea of India? For that matter, irrespective of her religion, if she does all that is expected of the average citizen and doesn't raise any slogan/salutation, should her patriotism come under question? And if lawmakers use toxic polarisation to consolidate electoral benefit, can the masses be really blamed for lynching and riots?

START-UP FUNDING
HIGH SHARE PREMIUM IS THE CONSEQUENCE OF THE MATHEMATICS UNDERPINNING VALUATION, NOT A CAUSE OF HIGH VALUATIONS

Section 56: 2(viib) or not 2(viib)

SIDDARTH PAI

Founding partner at 3one4 Capital



TO PARAPHRASE HAMLET, section 56: 2(viib) or not 2(viib), that is the question:

*Whether 'tis nobler in the mind to suffer
The slings and arrows of outrageous fortune,
Or to take arms against a sea of troubles*

This seems to be the question plaguing entrepreneurs all across India as many see looming tax bills of 30% of the amount of capital they've raised being levied against them. But to understand why the government seeks to tax capital receipts as revenue, we need to explore the context and history behind this section.

In 2012, during the UPA government's tenure, India witnessed the introduction of the "angel tax" and Section 68 through the following words of Pranab Mukherjee's in his last budget to Parliament, "I propose a series of measures to deter the generation and use of unaccounted money. To this end, I propose: Increasing the onus of proof on closely held companies for funds received from shareholders as well as taxing share premium in excess of fair market value."

The reason for this harsh insertion was due to the Enforcement Directorate (ED) uncovering several transactions involving Jaganmohan Reddy wherein people had "paid bribe to Reddy in the form of investments at exorbitant premiums in his various companies to the tune of ₹779.50 crore apart from making payment of ₹57 crore to him in the guise of secondary purchases of shares and donations of ₹7 crore to YSR Foundation" (bit.ly/2RruZ9w).

To counter this, the 2012 Finance Bill had tabled exclusive measures to "prevent generation and circulation of unaccounted money". This saw the introduction of a slew of measures such as sections 56(2)(viib), the taxation of premium in excess of fair market value, sections 68 and 69 for unaccounted cash credits and unexplained investments respectively, etc. The budget memo accompanying the

insertion of these sections also states, "the pernicious practice of conversion of unaccounted money through masquerade of investment in the share capital of a company needs to be prevented".

But is the legislative intent to tax unaccounted money received as premium or any and all share premium received by start-ups?

A legal test to analyse this comes from Heydon's Rule (1584), which requires the consideration of four matters in constructing any piece of legislation and the 2012 budget memo, *Measures to prevent generation and circulation of unaccounted money*, actually provides answers to all these questions:

■ What was the law before this enactment?

There was no single law before the enactment of these measures and, to cite the memo, "Certain judicial pronouncements have created doubts about the onus of proof and the requirements of this section, particularly in cases where the sum which is

credited as share capital, share premium, etc."

■ What was the mischief or defect for which the law did not provide?

The mischief for which the law didn't provide was "the pernicious practice of conversion of unaccounted money through masquerade of investment in the share capital of a company".

■ What was the remedy that the enactment provided?

The remedy the enactment provided was the insertion of section 56(2)(viib), 68, etc, to "deter the generation and use of unaccounted money".

■ What was the reason for this remedy?

The reason for this remedy was to create legislation and measures to "prevent the generation and circulation of unaccounted money".

Thus, this begs the question: why is a law meant to prevent the conversion of unaccounted money being used against all start-ups raising capital from known sources through bank transfers? It is clear that the legislative

intent is to prevent unaccounted funds from being laundered and not to tax any and all share premium as income.

Yet, this intent is being subverted and used as a weapon against all start-ups indiscriminately, purely on the basis of a high share premium. A high share premium is not the cause of a high valuation but the outcome of valid business decisions regarding the face value and capital base of a company. Furthermore, a relatively high share premium paid through accounted funds via bank transfers and proper compliance filings forms the antithesis of unaccounted funds that is at the heart of this legislation. This is best shown by the following example:

Start-up A chooses to begin its journey with an initial capital of ₹1 lakh. The balance sheet after incorporation is in the attached graphic. Its financials before any funding round are also described in the attached graphic. Start-up A manages to attract angel funding at ₹1 crore at a post-money enterprise valuation of ₹10 crore (arrived at via discounted cash flows) from various angel investors.

■ Share base: 10,000 shares
■ Face value: ₹10 each
■ Post-money enterprise valuation: ₹10 Crore
■ Share issue price: 10 crore/10,000 shares = ₹10,000
■ Share premium: (issue price - face value) = ₹9,990

The book value prior to funding would be determined as per the steps shown in the attached graphic and, post the ₹1 crore round of funding, the financials would resemble the values as also shown in the attached graphic.

Thus, start-up A, with a net asset value of negative ₹15, raised capital at a share premium of ₹9,990, a difference of 666 times! This shows how a high share premium is the consequence of the mathematics underpinning valuation, not a cause of high valuations. In the zeal to snuff out black money, caution must be exercised so that genuine transactions don't end up as collateral damage. After all, should the wicked consume the righteous?

Financials post incorporation			
Particulars	Amt (₹)	Particulars	Amt (₹)
Share capital	1,00,000	Fixed assets	60,000
		Cash	40,000
Total	1,00,000	Total	1,00,000

Assets - Liabilities	= 75,000 - 2,25,000
No. of shares issued	10,000
	= (₹15/share)

Financials before funding			
Particulars	Amt (₹)	Particulars	Amt (₹)
Share capital	1,00,000	Fixed assets	60,000
Shares	1,00,000	Cash	15,000
Losses	(2,50,000)		
Loans	2,25,000		
Total	75,000	Total	75,000

Financials post funding			
Particulars	Amt (₹)	Particulars	Amt (₹)
Share capital	1,01,00,000	Fixed assets	60,000
Shares	1,10,000	Cash	1,00,15,000
Share premium	99,90,000		
Losses	(2,50,000)		
Loans	2,25,000		
Total	1,00,75,000	Total	1,00,75,000

China's big lunar step doesn't give it the lead

As long as the US remains focused on cultivating its commercial space industry and continuing to fund cutting-edge science programs, it has little reason to fear falling behind

ADAM MINTER

Bloomberg

ON WEDNESDAY, CHINA successfully landed its Chang'e-4 spacecraft on the moon's far side—an impressive technological accomplishment that speaks to China's emergence as a major space power. Understandably, some Chinese scientists are taking a victory lap, with one going so far as to gloat to the *New York Times* that "We Chinese people have done something that the Americans have not dared try".

That cockiness speaks to the spirit of great-power competition animating the Chinese space program. China is open about the fact that it isn't merely looking to expand human knowledge and boundaries; it's hoping to supplant the US as the 21st century's dominant space power. And, if this were still the 1960s, when the American and Soviet space agencies fiercely competed against one another, China's deep pockets, focus and methodical approach to conquering the heavens might indeed win the day. But the truth is, thanks to the development of a dynamic, fast-moving American commercial space industry, China's almost certain to be a runner-up for decades to come.

That doesn't mean the People's Republic isn't making progress in its attempts to colonise the moon and turn it into the outer-space equivalent of its South China Sea outposts (an avowed goal of Ye Peijian, head of China's lunar program). China will launch a mission to bring back samples from the moon later this year. Over the next decade, it plans to launch a space station, a Mars probe, asteroid missions and a Jupiter probe, while continuing to develop reusable rockets and other vehicles that will enhance its access to space. A human mission to the moon is targeted for 2030, and a permanent colony by the middle of the century.

By contrast, NASA's own ambitions seem limited. American astronauts haven't left low-Earth orbit since the last Apollo moon landing in 1972, while the US lost the ability to fly to the taxpayer-funded International Space Station with the retirement of the Space Shuttle. Too often, new presidents have shifted space priorities, forcing NASA to cancel or reconfigure expensive missions that have been years in the planning. Worse, many members of Congress still view NASA as a tool to deliver wasteful, pork-barrel spending to politically connected constituencies.

But, that hardly describes the entirety of the US space program. Since the mid-2000s, when Congress authorised the agency to begin cultivating public-private partnerships, NASA's most important role has been as a seed investor and adviser to private space companies. While Elon Musk's Space Exploration Technologies Corp.—or SpaceX—receives the bulk of attention, the commercial space industry now comprises dozens of firms in fields ranging from small satellites to lunar exploration. The results have been spectacular: By NASA's own estimates, the cost of SpaceX developing its workhorse Falcon 9 rocket was less than 10% of what it would have cost if NASA had done it.

NASA's backing is paying dividends elsewhere, too. In coming weeks, SpaceX will launch uncrewed orbital test flights of its Crew Dragon spacecraft—a capsule designed to deliver US astronauts to the International Space Station. At least two other companies are looking to launch commercial space stations. Jeff Bezos' Blue Origin LLC is planning an uncrewed moon landing by 2023 (in line with NASA's lunar goals). Meanwhile, SpaceX is developing a larger rocket that is scheduled to take tourists around the

moon that same year. And NASA, keen to encourage more lunar exploration, just announced a partnership with nine companies developing lunar landers, with the first missions set to launch as early as this year.

Of course, space exploration isn't just about making money and colonising the moon. Science, too, remains a motivation, and there the US remains a global leader with a nearly insurmountable lead. Just this week, the New Horizons probe completed the most distant exploration in history (of a small rock 4 billion miles from Earth), and the OSIRIS-REx probe went into orbit around a small asteroid (that it'll sample in 2020). NASA also has—amongst other missions—one ongoing mission at Jupiter and four at Mars, a solar probe, and two spacecraft that have entered interstellar space.

Neither China nor any other country has plans to compete with this record of accomplishment, nor do they have the scientific or engineering experience to do so. As long as the US remains focused on cultivating its commercial space industry and continuing to fund cutting-edge science programs, it has little reason to fear falling behind. Better yet, it has a much better chance to attract space scientists and other talent keen to profit from one of the 21st century's most promising growth industries.

China, too, isn't oblivious to the potential of commercial space—it is developing its own industry—but the persistent dominance of China's state sector ensures that its entrepreneurs will spend as much time on politics as propulsion systems. If we're in a new race to the stars, the US remains a good bet to win.

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LETTERS TO THE EDITOR

History has been made

Hats off to India captain Sunil Chhetri on becoming the second-highest international goal scorer (67) among all active players. Chhetri's brace against Thailand in India's opening Group A battle of the Asian Cup 2019 at the Al Nahyan Stadium in Abu Dhabi took him past Argentinian superstar Lionel Messi and only behind Portugal's iconic forward, Cristiano Ronaldo. The Indian skipper also led from the front and helped his side script a sensational 4-1 demolition of Thailand, a triumph which was India's first at the Asian Games since June 1964 — Ravi Chander, Bengaluru

Reservation starved

The Modi government's move, at the fag end of its tenure, to give reservations for the upper castes on the basis of their economic condition goes against the very purpose for which reservation was introduced and constitutionally validated in the first place—to right or undo the historical wrongs and injustices. Clearly, it was brought in to appease the upper castes ahead of the 2019 general election. For the economically backward amongst the upper castes, economic assistance can be extended and not reservation. Affirmative action or positive discrimination is not meant as an instrument for poverty alleviation, but as a tool to make up for the inherited disadvantages. It is significant that the upper castes already have jobs disproportionate to their numbers. They seem to have no problem when it comes to putting the interests of the upper caste above 'merit' — G David Milton, Maruthancode

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Illustration: ROHNIT PHORE

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The mystery behind India's high inflationary expectations

Apart from perception, household inflationary expectations are influenced by shopping experience and media coverage. It's likely that media coverage of inflation is relatively less when prices are falling than when prices are rising, and that could be the reason for Indian household inflationary expectations being stuck at high levels, even while actual inflation has been falling

INDIA'S INFLATION HAS been falling, with the consumer price index (CPI) inflation touching a low of 2.3% in the month of November. Surprisingly, even with the CPI inflation falling, household inflationary expectations remain high. According to a survey by the Reserve Bank of India (RBI), household infla-

tionary expectations in the current year have remained close to 10%, even while the actual CPI inflation has averaged 4%. Household inflationary expectations are a critical parameter as these could impact actual inflation through households' wage-price negotiations and consumption/saving behaviour. In simple words, higher household infla-

tionary expectations can put upward pressure on actual inflation. India's central bank has been successful in containing the CPI inflation in its target range of 2-6%, but somehow this success has been elusive when it comes to reducing household inflationary expectations.

It is not surprising that household inflationary expectations are higher than actual inflation. Consumers tend to remember price increases more than price falls. Globally also, generally, household inflationary expectations have been found to be higher than actual inflation. For instance, the US household inflationary expectations (as measured by the University of Michigan consumer survey) for one-year ahead are currently at 2.7%, higher than the US CPI inflation of 2.2%. However, what is surprising in India's case is such a wide and persistent gap between the two.

Before we delve deeper into the mystery behind India's high inflationary expectations, it is worth taking a quick look at how RBI arrives at household inflationary expectations. RBI surveys around 5,800 households, from 18 cities, covering different age groups and occupational backgrounds. So, the survey covers people from financial services, homemakers, self-employed, retired persons, daily-wage workers and others. Apart from inflationary expectations (three-months' and one-year ahead), the survey also captures inflationary perception (what households think is the current inflation). This is where the interesting bit lies. The survey results show that households' perception of inflation in the current year has been around 8% (average), much higher than the average CPI inflation. An individual's perception of inflation has a high influence on an individual's inflationary expectations. In simple words, this means that while the average CPI inflation in the current year has been around 4%, households' felt that inflation during the year was around 8%, and hence they expect inflation one-year ahead to be at 10% (little higher than what they currently perceive inflation to be).

CPI inflation has come down in the last five years to an average of 4.8% (from 9-10%). However, average inflationary expectations in the last five years have been around 10%

Now, why is the household inflationary perception so high? Inflationary perception should be influenced more by prices of frequently-purchased items such as food and fuel. In that sense, it is surprising that inflationary perception is still high, given the disinflationary trend in CPI food. Fuel inflation has been high in the current year (because of the sharp rise in global crude oil prices, before the recent drop), and perhaps that could be putting upward pressure on household inflationary perception. Another reason could be the increasing share of non-food items such as health, education, entertainment, personal care and other services in the consumer basket. Inflation in these items gets captured in core inflation. Core inflation has remained relatively high and sticky at around 5-6%. So, is core inflation pushing up inflationary perception? Or it could simply be the high CPI inflation of more than 10% that we had just five years ago. Maybe the high inflation witnessed in the past has resulted in household inflationary expectations getting anchored at high levels.

One may even question the sanctity of RBI's Inflation Expectations Survey (IES). One critique of IES is that it covers mainly urban areas, whereas CPI covers rural and urban areas. However, that is not a very satisfactory explanation for such a wide divergence. Ravindra Dholakia, a member of the Monetary Policy Committee (MPC), has raised concerns regarding RBI's IES. Interestingly, Dholakia pointed out that business inflation expectation in India as measured by a survey by IIM Ahmedabad is much lower (4.5% in August 2018). Business inflationary expectation is also critical as it would impact actual inflation through pricing by firms, wage fixing and investment.

While businesses may be more tuned to actual inflation, another survey by RBI for gauging consumer confidence also shows households' concerns on the inflation front. According to the survey, consumer sentiments have been lingering in the pessimistic zone and one of the big concerns of households is rising prices, apart from lack of employment opportunities and income growth.

The wide differential between inflationary expectations and actual inflation is not a recent phenomenon. The CPI inflation has come down in the last five years to an average of 4.8% (from a high of 9-10% that we have seen in the past). However, average inflationary expectations in the last five years have been around 10%.

According to yet another study on inflation expectations (by Oliver, Yuriy, Saten and Mathieu), apart from perception, household inflationary expectations are influenced by shopping experience and also media coverage. The study notes that there is limited evidence of the impact of monetary

policy actions on households' inflationary expectations, especially in developed countries where inflation has been contained at low levels. Even in the case of India, it is logical to assume that households will be having limited knowledge of inflation dynamics and monetary policy. This makes RBI's task of lowering inflation expectations even more difficult. As far as media coverage is concerned, it's quite likely that the coverage of inflation is relatively less when prices are falling than when prices are rising. Could that be the reason for Indian household inflationary expectations being stuck at high levels, even while actual inflation has been falling? While there are no clear answers/solutions to this puzzle—of high inflationary expectations and low actual inflation—RBI definitely needs to address this issue, to make the inflation-targeting framework of monetary policy more effective.

Why the Indian Ocean matters

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Laying the foundations of a stronger and more resilient Indian Ocean

IN RECENT MONTHS, the Australian government has outlined a bold vision for stepping up engagement with the Pacific and South East Asia. This is deepening our relationship with the people of the Indo-Pacific and is helping build a stronger, more resilient neighbourhood. Our engagement with ASEAN is going from strength to strength, as witnessed by the historic ASEAN-Australia Leaders' Summit in Sydney in March and the Prime Minister's November summit with ASEAN leaders in Singapore.

Just as we are delivering in the Pacific and South East Asia, we are also deepening Australia's engagement in the Indian Ocean, which is experiencing rapid economic change and increased strategic competition. The Indian Ocean is of vital importance to Australia's interests in the Indo-Pacific. The region is home to 40% of the world's population, and five of our top-20 trading partners. Australia's blue economy, which includes the Indian Ocean, contributes close to \$50 billion per year to our economy, through offshore oil & gas, tourism, aquaculture, shipping and commercial fishing. By 2025, we expect this figure to be close to \$100 billion per year.

India is set to become the world's third-largest economy by 2030, and reaching this goal will see India as a key driver of continued global economic growth. There is no other market that will offer as many opportunities over the next two decades than India. In November, with Prime Minister Ram Nath Kovind in Sydney, Australian Prime Minister Scott Morrison committed to implementing the India Economic Strategy, a comprehensive blueprint for Australia to realise the benefits of India's enormous economic potential over the coming decades.

Australia has appointed Ministerial Champions for the lead sectors of education, agribusiness, resources and tourism. Australia excels in these areas, and our expertise can help complement India's continued economic growth.

At this week's Raisina Dialogue in New Delhi, I will outline Australia's commitment to support a secure, open, inclusive and prosperous Indian Ocean. Australia is taking a multi-tiered approach, investing more bilaterally, regionally and through mini-lateral forums, to shape the strategic and economic environment in the Indian Ocean region for the benefit of all nations.

The Indian Ocean region will be the focus for Australia's Indo-Pacific Endeavour 2019 (IPE19), our largest annual naval deployment, with five ships and 1,400 personnel. Engagement with India will be the cornerstone for IPE19, with our bilateral navy exercise AUSINDEX at its centre.

Moreover, the scale of defence engagement between Australia and India has grown significantly in recent years. In 2014, Australian and India conducted 11 major defence activities together; in 2018, this figure has climbed to 38.

This reflects the growing convergence between Australian and Indian interests across the spectrum, including on strategic and economic cooperation.

At a regional level, Australia has been investing considerable effort strengthening the Indian Ocean Rim Association (IORA), the region's only ministerial-level forum and which includes 22 member states. The IORA is an important vehicle for advancing cooperation in maritime safety and security, women's economic empowerment and the blue economy. We are also active participants in the Indian Ocean Naval Symposium and the Heads of Asian Coastguard Agencies Meeting, which we will chair in 2020.

Australia is pursuing new and innovative mini-lateral initiatives to build the web of regional cooperation. We have been working with India and Indonesia to explore avenues for increased trilateral cooperation in the Indian Ocean, just as we have been doing with India and Japan. We are also working quadrilaterally with India, Japan and the US, in support of a resilient, peaceful and prosperous Indo-Pacific.

Australia believes the Indian Ocean region can be ambitious in the development of its architecture and an enduring sense of community. ASEAN provides a positive example of how regional groupings of diverse nations can facilitate greater cooperation, and its success may be a useful template for the Indian Ocean nations to explore. Through our multi-tiered approach to increasing our engagement, we're helping lay foundations for a stronger and more resilient region that can address tomorrow's challenges.

ASEAN provides an example of how regional groupings of diverse nations facilitate greater cooperation, and it is a template for the Indian Ocean nations to explore over the long term

EXTERNAL AFFAIRS

A diplomatic mixed bag

There were successes on some fronts in 2018; not gaining entry into the Nuclear Suppliers Group was a setback

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behind playing great hands in the matter. As an aspiring regional hegemon in the South Asian region, with an aim to counterbalance China, India didn't want itself to be seen by Maldives as an aggressor.

Similarly, in Sri Lanka, a constitutional crisis took place, and again the world was watching India carefully to see what it will do in that situation. Like in the case of Maldives, India just came out with a statement that it is aware of the developments in the island nation and is watching the situation closely. This was a rather predictable behaviour on India's part, but again a good move overall. Sometimes, showing

restraint and underplaying its ascendancy is mark of deft diplomacy. This seems precisely to be the case with India's engagements in its immediate neighbourhood.

However, with Pakistan, the story was replete with many twists and turns. When Imran Khan got elected as the Prime Minister, few saw genuine hopes of relations between the countries getting restored. But within weeks after Khan's ascendancy, it became pretty clear that it would be business-as-usual between the two South Asian neighbours. The reason being that, on one hand, Khan expressed his desire to reach out to India and start a bilateral dialogue through constructive re-engage-



Russian President Vladimir Putin with PM Narendra Modi, in this file photo

ment, while on other hand brutal tactics of Indian soldiers by Pakistan-based entities continued. India, therefore, had to say 'no' to the proposed talks between the foreign ministers of the two countries on the sidelines of the United Nations General Assembly (UNGA) meeting 2018, as talks and terrorism cannot go together.

However, commentators were puzzled why India initially agreed for a bilateral dialogue, considering that Pakistan has historically not been a trustworthy neighbour. As usual, Pakistan raised the 'K' word (Kashmir) at international platforms like the UNGA, thereby souring its relations with India even more. To cut short, the

didn't make any significant changes to Indo-Pak relations.

The most interesting aspect of India's external affairs in 2018 was seen in its relations with great powers like the US, Russia and China. India has tried its best to have cordial relations with all these nations, without upsetting any of them. However, with India's growing power in the international system, great powers want the country to take sides and align itself with one or the other. Gone are the days when India could easily adopt a middle-path, a *madhyam marg*, and manoeuvre itself in the great power politics to sat-

isfy its interests.

With Russia and the US being antagonistic to each other on various fronts in 2018, both the countries wanted India to align with them. However, India managed to stick to its non-aligned approach in foreign policy, which has served it pretty well in the past. Russia's growing proximity with China and Pakistan has been a cause of great concern to India, as it has the potential to hamper India's larger security interests. Therefore, when PM Modi visited Sochi in Russia in May, it was perceived by many as India trying to recalibrate its ties with Russia, which has been the country's most trustworthy ally and a time-tested friend in the past.

India also reached out to China when Modi visited the country for the Wuhan Summit in April. China is India's biggest trading partner, and any conflict with that country will harm India's business interests. As a rule, cooperation is always better than conflict, but the caution is that cooperation should not be received at the expense of self-respect. The inaugural Indo-US 2+2 dialogue in September in New Delhi was the highlight of Indo-US diplomatic relations, which reflected Delhi's deft diplomatic efforts.

Not gaining entry into the Nuclear Suppliers Group in June was definitely a setback for India, but overall the year was a mixed bag for Indian diplomacy.