

Opinion

THURSDAY, FEBRUARY 14, 2019



HOUSE ACCOMPLISHMENTS

Narendra Modi, prime minister of India

[This house] saw the highest number of women members elected. Forty-four first-time women MPs were elected to the Lok Sabha this year and 203 bills were passed out of the 219 introduced

Rational Expectations

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And the sugarcane dance continues

Till cane prices are fixed at realistic levels, problem of high farmer dues and endless govt 'packages' will continue

CHANCES ARE, THE next time the government talks about what it has done for farmers, it will talk of how it will raise the interest subvention to another ₹6,000 crore of loans for 142 more sugarcane mills; right now, the 6% interest subvention has already been given for ₹6,139 crore of loans to 114 sugar mills to create additional capacity to produce ethanol for sale to oil PSUs to mix in the petrol. Apart from the fact that such 'packages' don't really resolve the industry's problem, there is also a controversy over their size. In the past, as well as this time around, the size of the 'package' includes the loans which get the interest subvention while, since the loans are to be repaid by the industry, only the interest subsidy should be calculated—in the current case, that's ₹368 crore per year for five years and another ₹360 crore if the additional ₹6,000-crore scheme is approved.

The real issue, of course, is the high cost of cane mandated by the Central government—states like Uttar Pradesh add to the Centre's Fair and Remunerative Price (FRP) to arrive at their State Advised Price (SAP)—that has no relationship with the market price of sugar. In the last two years (see graphic), ex-mill prices of sugar fell by over a sixth, but the FRP rose by 13%. Between FY10 and FY19, the FRP rose a little over two times while the ex-mill price rose by a mere 2%. Not only is the price of the raw material fixed, under the law, mills have to buy all the cane grown in the area allocated to them; an industry where the raw material price is fixed at artificially high levels while the price of the end-product—sugar—is low is asking for trouble.

Also, while the mills pay farmers over six months from October to March, they sell their produce—sugar and its by-products—over 14-16 months. So, when mills delay payments, this is only to be expected; yet, the government vilifies the mills, files warrants against the owners and even arrests the managers almost routinely. And while the government likes farmers to believe that it is its threats to various mill owners and a plethora of 'packages' that makes mills pay their dues, this is hardly the case.

The reality is that the arrears keep mounting till the cane comes in by the end of March; after that, the dues no longer mount, and since mills keep getting paid for their sugar and other products, they start clearing the dues. The cycle of mill arrears (see graphic) makes this clear. In 2012-13, for instance, arrears rose from ₹7,840 crore on January 1 to ₹12,702 crore on March 31, and then fell to ₹3,201 crore in September. As the new crop started coming in, these rose to ₹6,750 crore by January 1 the next year and further to ₹18,648 crore by March 31...the same cycle repeats itself every year.

At an aggregate level, if you don't factor in the time factor—ideally, this must be done, but the idea is to keep the example simple—mills buy around ₹90,000 crore of sugarcane every year, so their production costs are around ₹120,000 crore. What they earn from the 25-26 million tonnes of sugar they sell—another 5-6 million tonnes of production can theoretically be exported, but Indian cane costs 50-60% more than that in exporting nations—is around ₹90,000 crore, assuming an ex-mill sugar price of ₹30 per kg and by-product sales that are around 15% of the sugar sales. What this huge shortfall does, and more so if you take the sequencing of the inflows and outflows, is to destroy the balance sheets of the mills, making it difficult for them to even get loans to carry on business. Indeed, in some cases in UP, where the mills expanded dramatically in response to tax breaks announced by the state government—and later withdrawn by the next one—the problem is even more severe.

In this context, the Central government has done well to increase the amount of ethanol that oil PSUs have to buy from sugar mills to 'dope' the petrol they sell. While the permissible level was 10% till some time back, this has now been increased to 20%. Right now, the sugar industry sells around 260 crore litres of ethanol and the 'package' agreed to can increase this by around 200 crore litres more—assuming the additional ₹6,000 crore package is approved—in another 2-3 years; setting up extra capacity to produce ethanol gives a return of just 7% or so, so the 6% interest subvention was given to make it viable for industry to invest in ethanol capacity.

Assume the mills can sell an extra 100 crore litres of ethanol next year; based on the conversion ratios, this equals to around 1.6 million tonnes of sugar. Based on the price of ₹52 per litre of ethanol produced from 'B' category molasses, the mills will earn an extra ₹4 or so per kg of sugar, or ₹640 crore; as more molasses are converted into ethanol over time, especially with the 20% doping rule, the mills will earn more.

All of this is good news, but as is obvious, even an aggressive pace of selling ethanol is not going to cover the increasing gap between costs and earnings. If this is not fixed, the rising-dues-rising-arrests-farmer-protests dance will continue—and get bigger over time since exceptionally lucrative cane prices will ensure more production—till the sugar mills are not able to service bank loans, and this is getting tougher now thanks to the stricter RBI norms.

GreenCover

China's and India's greening efforts are praiseworthy, but meaningful climate action needs the West to act fast

THERE IS FINALLY some good news on the green cover front: a 20-year-long data record by Nasa—two satellites orbiting the planet captured up to four shots of every place on Earth every day since the mid-1990s—shows that this has increased, albeit marginally. Global green leaf area has increased by 5% since the early 2000s, and the main contributors to this have been China and India, accounting for one-third of the greening witnessed during this period. This should be a fitting retort to historical polluters like the US (the worst historical polluter) that have so far evaded taking responsibility of their role in climate change.

But, there also has to be acknowledgment of the fact that much of this improved green cover is at the cost of far-reaching ecological shifts—forests rich in species diversity are shrinking while single-species 'forests' are expanding. While this is a major concern, the much larger one is that the efforts by India and China are not enough even if they are ambitious from both the respective countries' standpoints. Meaningfully bringing down greenhouse gas emissions will need significantly scaled-up climate action by the US and other developed nations—and time is running out. The Trump administration has set the world back by miles by rolling back many Obama-era policies on emission reduction. The US could, indeed, now be looked upon as climate rogue having withdrawn from the Paris deal and having done all to scuttle any binding rules on meaningful climate action at Katowice.

BEGGING THE QUESTION

FOR EXAMPLE, IN 1911, THERE WERE 979,293 FAKIRS, 814,365 YOGIS AND 698,036 MENDICANTS. CENSUSES TODAY DON'T COLLECT THESE NUMBERS

How many religious mendicants are there?

AN UN-STARRED QUESTION on beggary was answered in the Lok Sabha on March 8, 2016, by the minister of state for social justice and empowerment. According to the Census 2011, the total number of beggars and vagrants in India is 413,670—221,673 males and 191,997 females. State-wise, with an aggregate of 81,244, West Bengal leads by a considerable margin, followed by UP. These numbers differ slightly from figures given in the ministry of social justice and empowerment's handbook on social welfare statistics (January 2016). The handbook has two sets of numbers from two separate sources—Census 2011 and SECC, 2011 (rural). From the Census 2011, there are 372,217 beggars and vagrants in India—197,725 males and 174,492 females.

What is a vagrant and why do we still use such a term? Several states have anti-beggary legislation—Andhra Pradesh, Assam, Bihar, Chhattisgarh, Goa, Gujarat, Haryana, Himachal Pradesh, Jammu and Kashmir, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Punjab, Sikkim, Tamil Nadu, Uttar Pradesh, Uttarakhand, West Bengal and Delhi. There can be an entirely legitimate debate about the working and refinement of this anti-beggary legislation, but that is not the focus of this column. The word "vagrant" is a colonial legacy from the English, reflective of the belief that able-bodied poor must be made to compulsorily work and not laze around.

England had a Vagabonds and Beggars Act in 1494. This went through several versions and eventually became the 1824 Vagrants Act. We still carry vestigial legacies of such notions in sections of the CrPC (Crim-

inal Procedure Code). What is the difference between a vagrant and a beggar? A vagrant has no fixed abode and wanders around. Is a vagrant a beggar who roams around? Is a non-beggar who roams around a vagrant?

By that definition, a religious mendicant is a vagrant. These are legal issues and can be pinned down only through a piece of legislation. In that list of state-specific legislation, all but two states incorporate beggary, but not vagrancy. The two Acts that mention vagrancy are the Bengal Vagrancy Act (1943) and Cochin Vagrancy Act (1945), applicable to some parts of Kerala. For West Bengal, a "vagrant means a person found asking for alms in any public place, or wandering about or remaining in any public place in such condition or manner as makes it likely that such person exists by asking for alms but does not include a person collecting money or asking for food or gifts for a prescribed purpose". Cochin has similar provisions. As I said, though the legislation may be directed against beggary, itinerant or stationary, it seems to legally cover religious mendicants.

As everyone knows, a Kumbh Mela is under way in Prayagraj. When I vis-

ited the Mela, I was told 100,000 sadhus have temporarily set up abode there. How does one know the number? I didn't get a satisfactory answer. I can understand some sanctity associated with the figure if the sadhu is a member of one of the recognised *akhadas*.

But not every sadhu is a member of an *akhada*. Broadening the question, how many sadhus/sannyasis are there in India? Broadening it even further, how many religious mendicants (irrespective of religion) are there? Typically, the Census should give answers. Indeed, pre-independence Censuses did collect such figures.

For example, in 1911, there were 979,293 fakirs, 814,365 yogis and 698,036 mendicants. Unless I have missed something, Censuses today don't collect these numbers. Take the household Census 2011 schedule, which is focused on main workers and marginal workers, with a few questions for non-workers. If I am a non-worker, I tick one of several options. I can say 'beggar', or I can say 'other'. Since "other" isn't disaggregated further, I think the Census should simply list 'beggar' and not 'beggar and vagrant'. To return to the question of a reli-

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What data collection happens for a religious mendicant? There is no household to be visited. How do I get the numbers, if at all?

The new avatar of 'Make in India'

Section 65 of the Customs Act, 1962, was a short-sighted and defeatist strategy, aimed at restricting imports, instead of looking at developing our capacity to export

RK SINGH

IRS officer and retired chief commissioner of customs



EVER SINCE THE finance minister's inspiring budget speech, a number of people have asked me to unravel, "to promote the 'Make in India' initiative...a revised system of importing duty-free capital goods and inputs for manufacture and export has been introduced, along with introduction of single point of approval under section 65 of the Customs Act".

Section 65 owes its origins to the Sea Customs Act, 1878. The earliest notification issued by the then Central Board of Revenue (CBR) dates back to 1927. References to eleven such relics are available even today on the Central Board of Indirect Taxes and Customs (CBIC's) website, all of which were springboards of early industrialisation. The Motor Vehicles (Manufacture-in-Bond) Rules, 1956 dated November 6, 1956, is a case in point, which sowed the seed of India's automobile industry with the iconic Hindustan 14 being manufactured for the first time by the Birlas in 1957. Electric gramophones were first manufactured in India under 'Rules for Manufacture of Complete Gramophone Machine (including Electric Gramophones) in Bond'—CBR notification number 9, dated the July 13, 1946, leading to the incorporation of the iconic Gramophone Company of India (let's pause a minute here, to think when and how we lost momentum in electronic manufacturing).

All these notifications were rescinded with the enactment of the Customs Act, 1962. A brand new provision—section 65—came into existence and was expected to achieve more. Instead, the Indian trade administration became manically obsessed towards conserving foreign exchange. It sent the country into a downward spiral with some short-sighted and defeatist strategies, aimed at restricting imports, instead of looking at developing our capacity

to export.

Section 65 went on to become an adjunct to the Export Oriented Units (EOU) scheme which was launched in 1980, but more as an instrument of restriction and control rather than export promotion. In addition, other complications like restrictions on sales in domestic tariff area and net foreign exchange obligations were also introduced. On top of that were administrative complications to overcome, such as an inter-ministerial board of approval, before you could actually get going. Outside of EOUs, requirement of import licences, high rates of customs duty and all sorts of regulatory clearances bred an inefficient and high cost industry, which continues to struggle till today when it comes to competing without tariff protection.

A quarter century later, the China-inspired model of special economic zones (SEZs) was conceived. Instead of copying the large and integrated SEZ model (five SEZs of China), India took a different path of building hundreds of SEZs. After a decade and half, we find that these contribute a mere 20% of our exports and that, too, with high import content and minimal value addition. The disappointing performance of SEZs can be attributed to legendary disagreements between regulators to controversies around land acquisitions, minimum alternate tax (MAT) and domestic market access.

Come 2019 and the finance minister's Budget announcement almost seems like a soft launch of what is perhaps the biggest reform, ever. It has opened a whole new book for manufacturing in India. The Central

Board of Indirect Taxes and Customs issued a circular (number 38 dated October 18, 2018), without any fanfare, laying down procedures of the scheme and clarifying some of the most challenging issues relating to accounting as well as clearances into the domestic tariff area. In two and half pages, it has done away with geographical restrictions applicable to the setting up of units under special dispensation. The scheme provides that any unit located anywhere in India is eligible to apply to the commissioner of customs for approval to manufacture under bond. There are no typical complications like inter-ministerial boards of approval. Best of all, imports of raw materials and capital goods are all duty-free till their final clearance.

Thanks to GST, the complications under Central Excise law on what would or would not tantamount to manufacture are gone. Now, any 'supply' from such a unit is subject to GST or IGST, as the case may be. Complications arising out of interest on duty deferred, multiple bonds, and bank guarantees have all been sorted out. CBIC's circular has gone the whole nine yards to prescribe a single bond as well as an integrated digitised accounting form.

Most interestingly, there are no thresholds of net foreign exchange earnings or export obligations while, at the same time, no duty concessions for clearances into the domestic tariff area (DTA). Yes, and you do get unrestricted access to the DTA. Overall, CBIC's scheme provides a level-playing field and fully leverages India's strong suit—land, labour, entrepreneurship and innovation. Capital, we warmly welcome!

The CBIC's October 2018 circular goes the whole nine yards towards removing export impediments and ensuring a level-playing field

LETTERS TO THE EDITOR

Hooch tragedy

The two principal reasons for the continued occurrence of hooch tragedies of the kind in Uttar Pradesh and Uttarakhand are people's addiction to alcohol and the failure of the administration to prevent the manufacture and sale of illicit brew made with all sorts of untested lethal ingredients. As always, in the present instances too, those who lost lives to gulping down the hooch were impoverished persons. If the problem of bootlegging is not seriously addressed, it is because no great value is attached to its possible victims—the anonymous people living in abject poverty and misery. Labourers who do back-breaking and hazardous work consume spurious liquor without being conscious that it can prove an instant killer. They delude themselves into believing that the consumption of intoxicant liquor alone will re-energise and replenish them for the next day's work. The government must ensure that nobody among those who cannot do without drinking for some reason or the other becomes a victim to the deadly brew due to its availability

— G David Milton, Maruthancode

Delhi hotel inferno

It is sad that 17 people have perished in the inferno that engulfed the Arpit Palace Hotel in Karol Bagh on Tuesday. Though a short circuit is suspected to be the reason behind the blaze that broke out on the first floor and spread to the upper floors, the management of the hotel must be held culpable for flouting building norms, which included running a makeshift restaurant on the rooftop. The Delhi hotel fire has raised concerns over the safety standards at budget hotels and the civic authorities must spare no efforts to rein in erring hotel owners

— Ravi Chander, Bengaluru

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ILLUSTRATION: ROHNIT PHORE

Digital dividend for insurance

PRANAY MEHROTRA & PALLAVI MALANI

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End-to-end digitisation of the process means lower costs, time-to-market

Digital tech is disrupting business models across industries. In insurance, it is challenging traditional insurers to re-imagine their business models. Today, most customers' experience with their insurer is defined by a complicated buying process, an ambiguous underwriting procedure and, then, an uncertain claims process. For customers whose experiences are increasingly getting shaped by their interactions on Uber, Paytm, Amazon and other such platforms, this experience is sub-standard. Insurers with pure-play digital models in other countries (e.g. China) have created end-to-end journeys that give a frictionless experience to the customer and are thereby challenging traditional insurers.

The opportunity at stake for insurers in India by digitally transforming their business models is significant. Digital driven re-imagining of customer journeys across the value chain of issuance, renewals, servicing and claims, can dramatically cut turnaround times by 60-80%, reduce customer complaints by half, optimise costs by 30-40% and build a business model ready for the future.

For example, the issuance process for a health insurance policy can be made near-instantaneous through the thousands of agents selling these policies. This includes:

- Intuitive digital front-end for agents, data validations built in to avoid re-work and few simple fields for fast form-filling. Overall, with less than three fields, a quotation can be provided in less than a minute, and with less than 10 fields, a policy can be issued in under five minutes. In addition, e-sign/OTP-based customer consent (in future, possibly enabled through Aadhaar) can completely make the process seamless. BCG's study with insurance agents shows that more than 70% are willing to adopt such digital tools.

- Automated underwriting with data-driven rule engines, automated checks and decisions, "swim-lanes" based workflows on policy issuance. Over time, this can be further enhanced with use of non-traditional data sources to increase accuracy of risk assessment leading to higher quality portfolio. Alternate data sources include, for example, wearables and IoT data, data from other platforms such as healthcare platforms, and data on social platform.

- End-to-end digitisation of processes with minimal-to-no manual touch—even in scenarios where health tests are required—can significantly reduce turnaround times. For instance, OCR-based reading of test reports and AI interpretation of the results can reduce the time consumed.

Other innovation such as facial analytics can minimise the need for physical health examinations. While the efficacy of these technologies is still to be tested at scale, an innovation pipeline that factors in potential developments is critical for sustained transformation.

While several Indian insurers have initiated digital transformation programs, the impact is less than required. So, what does it take to successfully drive digital transformation?

- Re-imagine customer journeys, not re-engineer: Take the customer perspective as the starting point, define the art of the possible (including learning from outside the industry), ensure end-to-end digitisation.

- Create agility @scale through cross-functional working with a minimum viable proposition based approach. In our experience, an agile approach shortens time to market by half, reduces development costs and drives higher employee engagement.

- Leverage partnerships: Companies need to recognise that they cannot build everything in-house and need to leverage partnerships for data and technology to scale up faster.

- Insurers need to continuously move towards a flexible, micro-services based IT architecture. The right culture and value proposition to attract the right IT talent is critical.

- Change the terms of measurement: Build a disaggregated (e.g. step-wise turnaround times) but end-to-end view, move beyond averages to 90th and 99th percentile.

- Sustained commitment to the transformation program from senior leaders. This cannot be delegated.

Digitisation is already starting to transform the insurance industry. The challenge—or opportunity—for insurers lies in determining the concrete steps to drive this revolution. Insurers successfully undertaking digital transformation programmes will capture a large share of value in the future.

PRALOK GUPTA

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E-COMMERCE FDI POLICY

A curveball for e-com players

The new policy introduces many changes that are likely to make doing business difficult for existing e-commerce players. Wrong to call it a mere reiteration of the earlier policy

place will not mandate any seller to sell any product exclusively on its platform only. Fourth, the e-commerce marketplace will be required to furnish a certificate along with a report of statutory auditor to Reserve Bank of India by September 30 every year for the preceding financial year.

The new policy also specifies criteria (not there in earlier policy) for defining inventory of vendors as the inventory of marketplace entity. The inventory of a vendor will be deemed to be controlled by e-commerce marketplace if more than 25% of purchases of such vendor are from the marketplace entity or its group companies. It puts the liability of conforming to this provision on the marketplace entity through RBI audit. There will be a number of implementation problems in ensuring this provision. First, how does a marketplace assess whether more than 25% of purchases of a vendor are from the marketplace or its group companies? Even if this is included as a contract condition by the market place with its vendors, what if the vendor changes its name and purchases the same goods under a different name? Who will audit the vendors? Is it RBI's or the marketplace entity's responsibility to certify if vendors are fulfilling this condition or not? RBI audit seems to be only for the marketplace entity and not for vendors.

The earlier policy required that an e-commerce marketplace entity will not permit more than 25% of the sales effected through its marketplace from one vendor or the latter's group companies. The new policy does not have any such provision. It is not clear whether this condition is now withdrawn or is still applicable to marketplace entities. If withdrawn, it reflects a major change with respect to the applicability of the group company obligations. Earlier, group company obligation was applicable to vendors, but now it is applicable to marketplace entities.

A misunderstanding of the new policy creates its with regard to ownership or control of inventory. On the one hand, the Press Note says that e-commerce entities providing a marketplace will not exercise ownership or control over the inventory. On the other, the clarification to this Note specifies that the present policy does not impose any restriction on the nature of products which can be sold on the marketplace. This would imply that the present policy does not prevent selling of private

labels. By their nature, private labels are owned by the entities. Thus, it implies that inventory ownership in the form of private labels is allowed. It would have been better if there were clarifications forthcoming on these implications.

Another potential area of confusion is with respect to cash-back provided on e-commerce platforms. The policy requires that cash-back provided by group companies of marketplace entities to buyers shall be fair and non-discriminatory. What about cash-back provided by the marketplace entity itself and not by its group companies? Does fair and non-discriminatory clause not apply to such cash-backs?

The government specifies that, in the marketplace model, goods/services made available for sale electronically on website should clearly provide the name, address and other contact details of the seller. Post sales, delivery of goods to the customers and customer satisfaction will be responsibility of the seller. What about services? Since this specifies satisfaction only with respect to goods, does that mean any dissatisfaction with regard to post-sale delivery of services will not be responsibility of seller?

The policy guidelines, as enumerated in Press Note (2), and the subsequent clarification are intended to prevent violation of the FDI policy on e-commerce and any circumvention of restrictions on multi-brand retail trading. Though, it tried to plug the gaps remaining in the

earlier policy, it has ended up creating new difficulties for various stakeholders. Given the substantial changes in the current policy, it would have been better if the government avoided calling it a reiteration of the earlier policy and called it a revised policy on FDI in e-commerce instead. It should also have consulted various stakeholders, including foreign players, before changing the policy. Since these players are allowed to do business in India by the government itself, they should have been given an opportunity to be heard. It is a different matter what policy options government would have chosen after consultations, considering the overall benefits to the economy, as the government has the right to change its policy stance, given how e-commerce is evolving in India. This is why India must resist attempts at the WTO to have binding rules on e-commerce as they take away the flexibility from the government to change policy stance, if situation warrants to do in future.

The govt should have consulted various stakeholders, including foreign players. Since the govt itself allows these players to do business in India, they should have been heard

WHILE THE GOVERNMENT ANNOUNCED its rejigged FDI policy for e-commerce recently, the e-commerce space in the country itself is set for an upheaval after Reliance's announcement of entering the space. The government announced its reworked FDI policy on e-commerce through Press Note (2) in the last week of December 2018, and issued a clarification in the first week of January 2019. According to the clarification, the government has only reiterated the policy provisions to ensure better implementation of the policy in letter and spirit. A careful evaluation, however, reveals that the policy revisions prescribed go much beyond reiteration of the policy and substantially change the FDI policy on e-commerce in India.

The Press Note states that the provisions of the policy will take effect from February 1, 2019. If this Note is only a

reiteration of the earlier policy, there should not be any need for specifying a future date for the policy taking effect. On the other hand, if there are provisions that were not there earlier but marketplace entities are now required to meet, it is definitely no mere "reiteration of the earlier policy".

As compared to the earlier policy enumerated in Press Note (3) of 2016, the new Press Note places new obligations on marketplace entities. First, e-commerce marketplaces or other entities in which e-commerce marketplaces have direct or indirect equity participation or common control should provide services (such as fulfilment, logistics, warehousing, advertisement/marketing, payments, financing etc.) to vendors on the platform at arm's length and in a fair and non-discriminatory manner. Second, cash-back provided by group companies of marketplace entity to buyers shall be fair and non-discriminatory. Third, an e-commerce market-

RCEP

NO ONE CAN DENY THAT there are net gains from free trade (FT). If the most efficient producers are provided access without artificial restrictions (political boundaries), it would optimise the costs for a given level of consumption.

But, how those gains are distributed is an unsettled question. We can have examples of countries losing out due to FT and others gaining at their expense. It is not even difficult to find examples of just one country garnering all the gains and all the others losing.

It is also possible that some gainers (s) gain disproportionately from free trade than others (making the diminished gain a loss). Unless a country is careful about what to avoid, it may end up a heavy loser.

An illustration of this (see graphic) seeks to demand-up the supply curve in the standard demand-supply analysis of microeconomics. The supplying units are arranged from the most efficient to least efficient from left to right. Efficiency is measured by how low the total variable cost is. The thick ridge line running over the top of various bars representing individual units comprises the supply curve. Those to the left of where the demand-curve meets the supply-curve get to supply the market. Those to the right will incur losses since market-price is less than their variable cost. This illustration studies the impact of removal of import duties after FTAs. After removal of import duties, the supply curve accommodates more overseas players to the left and pushes out some domestic suppliers to the right of equilib-

A fatal blow to manufacturing jobs

Opening up our manufacturing without proper employment impact assessment might prove disastrous

V KUMARASWAMY

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rium pricing which thus face closure. The net impact (the 'before' and 'after' scenarios) in the illustration is as follows:

- The government has lost whatever import duties it was getting from suppliers already competitive in the market. The entire amount accrued to these suppliers.

- The domestic consumers have benefited from a price reduction of less than 1%. This is most likely from better efficiencies of the overseas suppliers.

- There is a net loss in domestic employment (9%) translating into better employment or capacity utilisation overseas.

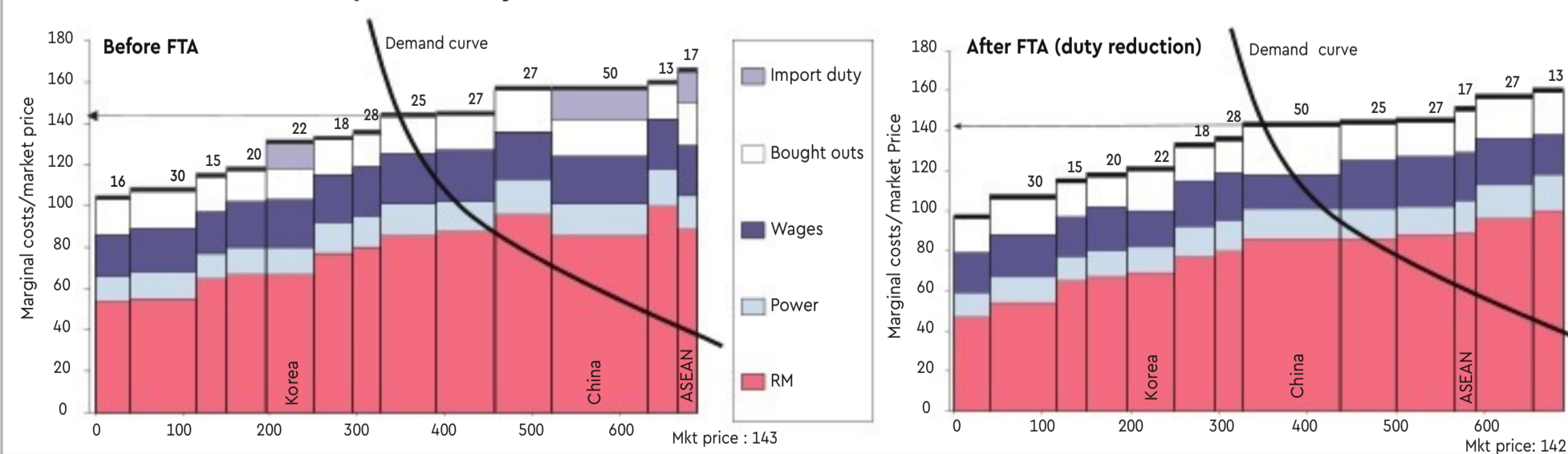
This kind of relatively flat demand or supply curves prevail in commodity industries where consumers don't pay much premiums for brand and supply efficiencies come from factor cost differences, scale

economies, cheap labour, patents, etc.

Larger concentration of capacities enabled by FT facilitates mechanisation and results in net loss of employment. These net losses in employment have also to be distributed, and one can end up with a disproportionate share of this unemployment as in the above case where the host country ends up with all the employment loss.

One of the methods oft-used by trade economists to identify industries with export or import competitiveness is the Revealed Comparative Advantage (RCA) and its variants. Essentially, this method calculates the ratio of (i) % of a particular commodity in a country's exports to (ii) % of global exports of the commodity in world exports. If the ratio is more than 1, then the country is supposedly export competitive.

Before and after FTA - impact of duty reduction



Instead of global %, one may use specific country %, regional %, or host country's %, to identify export competitiveness or import vulnerability.

But, it is terribly reliant on the past. What is important is the current competitiveness in an ever dynamic world, where the steep price fluctuations in some key inputs like oil, metals, interest rates, etc, can vastly change the fate of several players' competitiveness.

As can be seen from the illustration, the units around the equilibrium price—maybe 20-30% on either side—would largely decide the gains or losses from trade. Units which are highly competitive (left-most) or least competitive (right-most ones) will hardly matter. For example, ASEAN units, despite a duty reduction, do not enter the Indian market. There may not be much gain in negotiating access in such a commodity

if we are in a similar situation.

In the case of Regional Comprehensive Economic Partnership (RCEP), this kind of analysis should be done for commodities where we have some strength and where we would like to invite competition. Using elasticities alone may not suffice as much depends on capacities of individual players around the equilibrium price. ASEAN FTA has not resulted in much gain or loss over the five years since it has been in full operation.

Many Chinese commodity players have huge capacities—in some cases, a single unit/player has enough capacity to supply the entire Indian market. If an import facilitating measure or cut in duties make them competitive in India, then the entire Indian domestic manufacturing can get wiped out, resulting in loss of employment.

India's strength is its low-cost labour,

largely untrained and low-skilled. In most manufacturing units, the wages account for 8-12% of the cost and even this proportion is dwindling by the day. Even 30-40% cheaper labour translates to only a 3-5% overall advantage, not even sufficient to counter high real interest rates. But, where wages constitute 40-50%, like in many services—IT, design, etc—30-40% cheaper labour can give a 10-20% advantage. These are also less capital- and machine-intensive, and interest rates have a lower impact.

India's negotiation in trade agreements has not been stellar. Opening up manufacturing without proper impact assessment might prove disastrous with RCEP. Even if services are negotiated well, it will open up opportunities for the highly skilled, but the low-skilled labour, newly transferred from agriculture, may be left in the lurch.