Business Standard
Volume XXIII Number 138
MUMBAI | MONDAY, 25 FEBRUARY 2019

Missing the big picture

Draft e-commerce policy goes overboard on data protection

The new draft e-commerce policy, issued on Saturday, is focused more on privacy of data and promoting Indian businesses than on enabling the growth of an industry that has caught the imagination of an entire generation and more. But the over-emphasis on India's right to own Indian data and restricting its free flow may take away from the primary objective of having a vision statement for e-commerce. Pegged at around $40 billion, e-commerce, excluding travel and tourism, is projected to grow to $200 billion by 2026 in the country. With e-commerce holding a single-digit market share in the $860-billion retail pie, the room for growth is significant. The government, therefore, should fully engage with the stakeholders to understand the needs and challenges of the e-commerce sector rather than finalising a policy document based on limited goals in a hurry. There's no doubt that protection and privacy of data are important areas for policymakers. But, as pointed out in the draft, a comprehensive framework — Data Protection Bill — is already underway.

Besides data, which is often referred to as the new oil, the draft looks at infrastructure development, e-commerce marketplaces, regulatory issues, stimulating domestic digital economy and export promotion through e-commerce. Since e-commerce foreign investment norms were updated recently, triggering structural changes in online retail firms, this draft policy has reiterated some of the points especially related to a level-playing field between global and Indian companies. The government has the responsibility to ensure that India's development aspirations are met, while preventing market failures and distortions, it states. Mentioning that just a handful of companies have managed to dominate the digital economy, the e-commerce draft policy makes a case for giving indigenous offers such as Aadhaar and BHIM their due. The draft is sprinkled with references to Make in India and Digital India — signature schemes of this government.

While the intentions of job creation, data protection and helping Indian businesses grow are not at fault, the government must recognise the need for an overarching policy to guide the retail universe, including physical and online commerce, single brand and multi brand, B2C and B2B, Indian and foreign businesses. Isolation of e-commerce as a data-centric digital business is like missing the big picture. The draft, which has been in the making for long, has come up just ahead of the Lok Sabha elections, putting a question mark on whether a policy can be framed in time.

Admitting that there's no legal framework for the government to restrict cross-border flows of data, the draft argues without having a huge trove of data generated within India, the possibility of domestic businesses creating high-value digital products would be almost nil. It's also driving home the point that it's vital to retain control of data to ensure job creation. And, just like oil cannot flow freely, data should be monetised for the benefit of India and its citizens. Making India office and local representatives mandatory, the new rulebook would make it tough for several international companies including those from China to continue with their e-commerce business in the country. The gifting route that many Chinese companies have adopted will be stopped. The policy may also end up penalising big service providers like Facebook and Google, making them less inclined to launch new products in India. Besides, some of the suggestions to control trans-national data flows may look good on paper, but are impractical.

The FDI problem

Indian economy appears to be less attractive to foreign investors

The Indian economy appears to be losing attractiveness to foreign investors. This is the most reasonable conclusion from figures released recently by the Department for Promotion of Industry and Internal Trade (DPIIT). The figures show that, between April and December of 2018, foreign direct investment (FDI) in India fell to $33.5 billion, as compared to nearly $36 billion over the equivalent quarters of 2017. These figures have been released with a long and mysterious delay, in spite of the fact that the Reserve Bank of India (RBI) has regularly been passing along the required data to the DPIIT. It is unclear why the figures are being rationed in this manner.

That these figures consist of a reality check for the government cannot be denied. The initial years of the National Democratic Alliance government were good for FDI, reflecting enthusiasm for the economy's prospects after some years of policy paralysis under its predecessor. The government took credit for that momentum. If that trend has reversed, it must own up to an equivalent responsibility. The RBI figures suggest that inward FDI grew by just 3 per cent in 2017-18 as compared to 25 per cent in 2014-15, the financial year during which this government took office. Other, unofficial indicators also back up the theory of a presumed loss of confidence in the Indian economy. India fell three places in the latest 2018 AT Kearney FDI Confidence Index, dropping out of the top 10 destinations for the first time since 2015.

What could explain this slowdown? It is true that global FDI in 2018 fell by 19 per cent, according to the United Nations Conference on Trade and Development (UNCTAD), some of it driven by the repatriation of earnings by multinational companies registered in the United States. But India's peer countries were not doing so poorly. Southeast Asia, for example, saw an increase in FDI inflows of 11 per cent, to $145 billion — three times what all of South Asia put together received. So a more India-specific explanation than an overall decline in FDI will be required. The government has some explaining to do. For most observers, in the absence of an explanation from the authorities, the implication will be that concerns about sovereign risk in India have not gone down. The first draft of the e-commerce policy, which singled out e-commerce operators with foreign investment for harsh regulation that would hurt both investors and consumers, is an example of policy-driven sovereign risk that disincentivises FDI flows. Many big investments have already been made in e-commerce in India, and now the government has changed the rules of the game — exactly the sort of behaviour that investors rightly deplore. The second draft released on Saturday didn't move the needle much on this aspect. It is also likely that, notwithstanding the government talking about increases in India's position on the World Bank's Ease of Doing Business index, too little has changed on the ground in terms of investor-friendliness. It is up to the next government to not squander any goodwill from the investment community, so as to ensure that FDI flows are high and sustained.

ILLUSTRATION BY AJAY MOHANTY

The joy of exit

Why are downturns in India so long? One factor is the slow exit of firms

SNAKES & LADDERS

AJAY SHAH

In his column in *Business Standard* on Saturday, T N Ninan showed the gloomy environment of private businessmen facing difficulties. There are major difficulties in the Indian arrangements of the relation between the state and the market. But there is a silver lining: The exit of the weak boosts the profits of the survivors through higher output prices and lower input prices. This process of exit is accelerated by the bankruptcy reform. Greater leverage fosters less sentimental decisions. When exit is swift, business cycle downturns are shorter.

The heart of a business cycle downturn is private sector optimism and investment. Why has optimism declined in India? Every infrastructure company has stories about a government that does not pay on time, and a government system that does not flinch when violating contracts. Similarly, instability or perversity of regulation, taxation and agencies have hampered many a business. The daunting government interface, along with the lack of the rule of law, has fed into the lack of animal spirits and investment. Conversely, investment booms are born of reform teams that solve these problems.

Alongside this are the competitive battles within each relevant market, where creative destruction plays out and the death of firms reshapes the profitability of the survivors. We focus on that process here.

Business cycle conditions turned in 2011-12. About 40 per cent of the Indian corporate balance sheet had a lot of debt, coupled with sluggish revenues and profits. In most cases, the can was kicked forward by borrowing from Peter to pay Paul. This was supported by banks who were also keen to hide the bad news.

The bad news has increasingly crept out. The Insolvency and Bankruptcy Code (IBC) has helped. Banking regulation has improved a little. At first, debt growth shifted from banks to mutual funds and non-banking financial companies (NBFCs). After the IL&FS default in August 2018, that process is now taking place in a more cautious way, which is making debt rollover harder.

We economists have some good cheer to offer to every worried private practitioner: The very destruction of some private businesses, which we see around us, will help the survivors. We have an optimistic phrase, "creative destruction", for the death of firms.

The long Japanese stagnation led to the invention of a phrase "zombie firm". A zombie firm is a firm that ought to be dead, but is selling in the market through artificial life support. The presence of these firms harms the health and investment of the firms that they compete with.

The presence of one Air India, and the relatively modest injection of taxpayer money into Air India every year, impacts the health of the entire airline industry. When we prop up zombie firms, there is an amplification in translating modest fiscal expenditures into industry-wide impact.

Conversely, the exit of (say) Reliance Communications reduces competition in telecom, and gives a slight uptick in the profitability of the survivors. This process is playing out in every industry. The survivors breathe easier when a rival collapses.

The favourable impacts run deeper. If an Air India exits the industry, it frees up resources for the survivors. The price of pilots will be reduced when Air India's pilots seek jobs with private airlines. When Air India exits, it will free up credit lines and industry exposure limits, which will then be used by other airlines.

When Air India's real estate holdings all over the country are sold, the price of real estate is reduced for everyone. But to the extent that many of these locations suit the requirements of airlines, surviving airlines will get a bigger favourable impact. The sale of spectrum by Reliance Communications reduces input prices for all survivors.

The survivors thus benefit from exit on the product market (with slightly higher product prices) and on factor markets (with slightly lower prices for factors of production). Reduced prices of land, labour and capital are a key part of the process, through which profitability is re-established after a business cycle downturn.

By this reasoning, when exit takes place quickly, it is better for the economy. When zombies linger long after their lack of viability is established, the harm that they cause the economy is increased. It is better to make a clean break and move on. This is the logic of the bankruptcy code, and this is why we should have no policy bias in favour of liquidation versus resolution in the bankruptcy process.

In the Indian story of recent decades, we had an investment boom in the early 1990s, and then we had a long downturn from 1998 till 2002. We then got good times from 2003 till 2011 and a long downturn from 2011 onwards. There are long painful periods: From 1998 till 2002 and then from 2011 onwards. Why are downturns in India so long?

One factor is the slow exit of firms. Banking regulation and the government apparatus have traditionally worked together to favour zombie-fication. We have begun changing course with the IBC. By building modern banking regulation, and by building the bankruptcy process well, we will create a world of rapid exit of low-productivity firms. This will give shorter downturns. As I read T N Ninan's column, I thought how nice this was for the rivals of the firms who have collapsed.

We often revile firms that have borrowed a lot as greedy or over-optimistic. But from the viewpoint of the economy, it is a bit better to have leveraged firms.

Consider a low-productivity firm with all equity financing versus the same firm with a lot of debt. There is a danger that shareholders are sentimental, or illegally skimming cash, and thus keen to hang on to a company that produces poor returns on capital. Borrowing, the pressure to repay, and the bankruptcy process help close the door upon such sentimentalism. A leveraged strategy ups the ante, and forces the firm to perform or exit. An economy is more dynamic if there is more debt.

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Middle-class environmentalism is over

DOWN TO EARTH

SUNITA NARAIN

A few fortnights ago I asked the question if countries like India could afford to take the beaten path to economic growth and sustainability or we would have to reinvent. I also said that there was little appetite to do growth differently, but it has to be.

Take the agrarian crisis, which is on our head today. For once the face of the farmer is in the news. It is clear that whatever governments — past and current — have done is not working. Indian farmers are caught in a pincer — on the one hand, the food they grow is costing more to produce because of the higher costs of inputs, including resource depletion like water or soil, and also because of greater risks because of variable and extreme weather. On the other hand, governments want cheaper food to keep down inflation and also because they need to procure vast quantities to supply under the public distribution system. They need costs in control. There is little investment in the infrastructure to provide marketing support or benefits to producers. In all this, the risk to the business of farming has grown because of climate change and variable weather.

There is also the strong belief — coming from the well-established economic lexicon — that farming is now under-productive or unproductive and that it needs to be pushed back. There are too many Indians involved in this unproductive business, it is said. It cannot be made to work.

But this is where there are no answers. If farming — the business of growing food — will not be the business that will provide employment, then what will? The formal economy that we want to adopt so desperately is good for everything but employment. We know that.

What we must also recognise is the urban face of this farm crisis. Today if land, water or forests have no livelihood future, then people have no alternative but to migrate. This migration will bring them to cities, where the crisis of services and pollution will grow. The fact is that today's urban growth is not in the "legal" areas — where housing and commercial establishments are in the light of governance. What is clear is that cities are imploding in illegal areas, where business and housing are all without official sanction — or at least on the books. The irony is that as much as the government works to formalise the Indian economy, conditions force people into illegal and informal businesses.

The same happens with the protection of the environment. In our case we cannot export our environmental cost to another country. But we do export it out of the formal business, working in the formal industrial area, to unauthorised and out-of-bounds residential areas. Now business pollutes but it is out of the ambit of regulators. It gets dark. The cost of regulation is what makes governance expensive. Unaffordable for a country like India. So, pollution grows. Bad health grows.

But what is also clear is that the backyard of the poor is enjoined to the front-yard of the rich in a country like India. If business turns illegal, then regulation of its emissions becomes a greater challenge, this then means that the airshed is polluted. It affects the rich and the poor. It is the same with sewage and industrial effluent — the illegal discharge of the poor, when mixed with the treated effluents of the rich, still kills rivers. The pollution of our waterbodies adds to the contamination challenge and health burden. It is the same with garbage — the "illegal" settlements with virtually no services will burn their waste, adding to toxins in the same air.

This is why the model of globalisation, which shifted emissions but did not reduce consumption, will not work for us. We can move the pollution to our backyard, where the poor live; we can even discount the costs of environment and labour, but we will face the brunt of this. Nobody else. There is no escaping this fact. Today, as the Chinese close their door to plastic and other wastes of the western world, they are learning the pain of their disposal. There are more and more protests, in poorer regions of the US, for instance, where waste incinerators are being set up. People do not want emissions in their backyard. Who would? This, then, is the challenge.

It is for this reason I keep saying that middle-class environmentalism will not work in India — for us sustainability is about inclusive and affordable growth. But maybe, just maybe, it is time the age of middle-class environmentalism, which advocated technocratic solutions and pushed the problem to another region or another day, died. There is no other planet that can take our waste. It is time we understood this.

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Mistakes that led to Trump

BOOK REVIEW

JASON ZENGERLE

You can say this for the presidency of Donald J Trump: It has familiarised Americans with a number of heretofore obscure facets of their country's governmental system. The emoluments clause, the 25th Amendment, the Foreign Intelligence Surveillance Court — once upon a time, discussions of the dangers of a president taking money from a foreign state or the prospect of his cabinet removing him from office were the stuff of fiction; the ins and outs of how to get a wiretap on an American citizen were confined to law review articles. Today, they're the subject of front-page newspaper articles and cable news updates.

But there's even more arcana we need to learn in order to understand this moment. Enter the veteran liberal political writer Michael Tomasky and "If We Can Keep It," his sweeping, rollicking, sometimes breezy political and cultural back story to our current moment, one that demands we become informed, among other things, about the Connecticut Compromise, the career of Martin Van Buren and the Supreme Court decision in the Marquette National Bank case. Add it all up and Tomasky hopes to answer a fundamental question: how "our system became so broken" as to elect someone like Trump.

Tomasky begins at the 1787 Constitutional Convention. (His book's title comes from the perhaps apocryphal answer Benjamin Franklin gave to a question about what kind of government he and his fellow delegates had created: "A republic, if you can keep it.") He contends that the Connecticut Compromise, designed a fatally flawed system for our federal legislature. By mandating that the Senate be made up of two representatives from each state, they gave outsize influence to sparsely populated states. As for the House of Representatives, a blasé attitude about maintaining districts of equal size led to inequality, with rural areas of 10,000 constituents having the same representation as urban ones with 50,000 constituents. This situation only changed with a 1964 Supreme Court decision mandating "one person, one vote." "The founders were visionaries," Tomasky writes. "But they were human. They made some mistakes."

Van Buren is similarly flawed in Tomasky's telling. Today, if he is remembered at all, it is as a little-known former president. But Tomasky argues that Van Buren's more important role was as the mastermind of Andrew Jackson's 1828 presidential campaign. Unlike the founders, who disdained political parties, Van Buren was a firm believer in them. In laying the groundwork for Jackson's ascendance, he travelled the country trying to revive the two-party system, which had ended with the demise of the Federalists in 1816. He succeeded and Jackson's election gave birth to today's Democratic Party. Van Buren, Tomasky writes, "is the father of the modern political party, and therefore in some sense the man we might call the godfather of polarisation."

Marquette National Bank of Minneapolis v. First of Omaha Service Corp (1978) was "a pulverisingly dull case," which ruled that banks should abide by the usury laws of the state in which they were chartered, not where their customers lived. By making this change, the court drove banks to move to states with the lowest, or even no, interest rate regulations, leading to an explosion in the credit card business and, as a result, an explosion in consumer debt. Where Americans had once cherished "thrift, discipline, doing without," Tomasky writes, "in the late 1970s and early 1980s, Americans started to become a different people than they had been." He adds: "Our consumer selves have overwhelmed our citizen selves."

Tomasky excavates these and other bits of largely forgotten history in the service of making two main points about our current predicament. The first is that American politics have always been polarised but that the polarisation of today is qualitatively different — and more debilitating — than the norm. For much of the nation's history, Tomasky argues, there was a significant amount of "intraparty polarisation" with the divisions among Democrats and Republicans "over slavery, Reconstruction, civil service, gold and populism" often being deeper than those between parties. Today, by contrast, Democrats and Republicans are more "ideologically coherent" and we have such extreme "party tribalism" that "the members of Team A think it's an existential crisis if Team B wins." "The Democrats of the 1800s were arguing about whether slavery should exist," he notes. "Hillary and Bernie, for all the *sturm und drang*, were arguing about whether the minimum wage should be $12 or $15, and whether college should be affordable or free."

His second point is that will is "the most overrated commodity in politics." "It's useless to hope that politicians can just go back to getting along the way they once did," Tomasky writes. "They didn't get along better in the old days because they were nicer people, or because they had the will to do so. They got along better because a particular set of historical forces and circumstances produced a degree of social cohesion that called on them to cooperate more. Today, a totally different set of historical forces and circumstances exist."

Tomasky proposes a raft of reforms to get us out of the polarised mess we find ourselves in. Some, like ending partisan gerrymandering and getting rid of the Senate filibuster, are familiar. Others, like reviving "moderate Republicanism," are probably futile. But some of his proposals — including starting "foreign" exchange programs within the United States so students from rural areas spend a semester at a high school in a city, and vice versa — are both realistic and novel.

Indeed, the most helpful — if sobering — point Tomasky makes is that while our current troubles created the conditions that brought us a President Trump, those troubles would exist no matter who was in the White House. And it will take much more than a new occupant to fix them.

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IF WE CAN KEEP IT
How the Republic Collapsed and How It Might Be Saved
Michael Tomasky
Liveright Publishing
273 pages; $27.95