

# The Budget, the Survey and the trilemma

The Economic Survey correctly argues for investment-led growth. The Budget understandably wants to tap a cheap pool of global savings. But can these co-exist?



### INSIGHT

SAJJID Z CHINOY

Two big themes emerged from this year's Economic Survey and Budget — one explicit and the other more implicit. The Survey explicitly batted for re-stoking investment-led growth. This is foundational. As the contrasting experiences of Latin America and East Asia — as well as India's own experience in the mid-2000s — have revealed, strong growth can only be sustained when underpinned by private investment. Bursts of consumption-driven growth are unsustainable because they inevitably spawn imbalances, either domestic (higher inflation) or external (wider current account deficits). An investment-led strategy therefore has to be the lynchpin for sustained 8 per cent growth.

Meanwhile, a key theme emerging from the Budget was a conscious strategy to rely on greater foreign savings. Hence the Budget enumerated a series of measures to attract more FDI, foreign portfolio investment, and issue a sovereign dollar bond. The motivation is unsurprising. With household savings declining in recent years (as households have dipped into savings to support consumption growth) and the public sector using up virtually all household financial savings, concerns about private sector crowding-out have progressively risen. On the flip side, the global inter-

est-rate cycle has turned again in 2019 with G3 central banks expected to ease further. Why not tap cheap foreign savings to fill the gap?

While this may alleviate short-term domestic pressures, a medium-term strategy to harness foreign savings is incompatible with an investment-led strategy to drive domestic growth. Why is that? Because an investment-led strategy is necessarily an export-led strategy. Here's why.

**Investment & exports**

If the investment rate has to rise, the domestic savings rate must rise in tandem. If not, the current account deficit (which is just the investment-savings gap in an economy) will balloon, increasing macroeconomic uncertainty and choking off the very investment that is needed. However, if the savings rate has to go up, by construction, consumption to GDP will have to come down.

But if consumption to GDP is coming down why would the investment rate be presumed to go up? Why would entrepreneurs accelerate investment if consumption growth is slowing? Only if exports — the other driver of demand — are growing rapidly to make up the difference. And therein lies the key: That for any investment-led model to sustain, it must necessarily be driven by strong exports growth. Otherwise the model is internally inconsistent and unsustainable. Therefore no country has experienced close to double digit-growth without investment and exports acting in concert.

This combination is exactly what drove India in the mid-2000s. Between 2001 and 2006, GDP growth averaged almost 8 per cent, and investment growth averaged 16 per cent a year. Guess what drove investment? Exports — which grew 20 per cent a year in those years. In contrast, private consumption grew at 7.2 per cent — less than GDP

growth — such that consumption-GDP fell and the savings rate went up to help finance investment. India became China-like in the mid-2000s, till the global financial crisis hit.

We need an encore. For strong growth to sustain, India will need sustained investment. But for investment to be sustained (and financed at home) India will need exports to fire.

**Exports & the exchange rate**

And herein lies the tension. If growth is to be driven by exports, it's incompatible with an excessive reliance on foreign savings (and the associated capital inflows) that will put upward pressure on the exchange rate. There is a casual belief in India that exchange rates don't matter for exports. However, as we have previously shown in an empirical analysis at the India Policy Form, exchange rates — along with global growth — are a crucial determinant of India's exports.

Export growth surged between 2005 and 2011, growing at 14 per cent a year. Since then, they have slumped to 4 per cent average growth. Some of this is, undoubtedly, because of both slowing global growth and deglobalisation. But, as we have shown in our IPF paper, some of the export slowdown is also attributable to the 20 per cent appreciation of the real effective exchange rate (REER) between 2014 and 2017. To be fair, there was little policymakers could have done to prevent the appreciation because it was the upshot of a large, positive terms of trade shock to the economy from lower crude prices along with strong capital inflows which — as theory suggests — should cause both actual and equilibrium real exchange rates to appreciate.

As crude prices climbed back up,

the REER depreciated almost 10 per cent in 2018, but more than half of that depreciation has reversed in recent months. All told, therefore, the REER is still almost 15 per cent stronger than it was five years ago. Some could argue this is not worrying because it simply reflects higher productivity growth in India. But that hypothesis does not gel with the fact that India's underlying current account balance (ex oil and gold) has consistently worsened over the last five years — suggesting external competitiveness is increasingly under pressure. If the REER was reflecting productivity gains, competitiveness wouldn't be getting progressively threatened.

**The exchange rate & the trilemma**

It will be hard enough to boost exports in a world of slowing growth and rising protectionism and nativism. What India doesn't need is for the exchange rate to compound the challenge. It's therefore important for policy not to inadvertently induce further appreciation pressures. The real exchange rate is impacted by several factors: productivity differentials, terms of trade, government spending, and capital inflows/net foreign assets. Therefore, any policy that aggressively attempts to attract capital inflows risks inducing more appreciation. In 2017-18, for example, capital flows surged to 3.5 per cent of GDP pushing up the broad REER by almost 5 per cent that year alone.

But couldn't the RBI intervene to prevent appreciation? For starters, because the real exchange rate is driven by fundamentals, the central bank cannot meaningfully influence it over any length of time. Second, even when

attempting to influence the nominal exchange rate, the central bank comes up against the trilemma. With India's need for independent monetary policy, the more the capital account is open, the less control policymakers will have over the exchange rate. To be sure, sterilised intervention does give the RBI some degrees of freedom, but this is not without distortions. Over the last two months, for example, India has received strong capital inflows after the decisive May election result. On its part, the RBI has intervened aggressively to prevent a rupee appreciation. Much of this has been sterilised by paying forwards in the foreign exchange market. But this has also contributed to pushing up the forward premium, which will disincentivise corporates and importers from hedging, risking financial instability. Similarly, had the RBI intervened only through buying dollars in the spot market and then soaked out the liquidity through OMO sales, it would have pushed up domestic bond yields, and potentially attracted more "carry inflows". In other words, there's no free lunch.

All told, therefore, a strategy that relies on foreign savings risks putting more upward pressure on the real exchange rate and impeding export growth, at a time when exports will have to catalyse investment.

So what should authorities do? First, don't resist rupee depreciation, particularly if the Chinese yuan is also depreciating, because India's greatest competitiveness concerns are vis-à-vis China. Second, avoid excessive reliance on foreign savings. Instead reduce total public sector borrowing so that more domestic savings are available to finance domestic investment. Once investment gets a fillip, savings will rise in tandem given their pro-cyclicality. Third, double down on factor market reform, infrastructure and transportation logistics to improve external competitiveness, and expand India's global export share, thereby creating the impetus for an investment revival.

All this won't be easy, but is unavoidable if we aspire for sustained 8 per cent growth.

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### CHINESE WHISPERS

**Naidu raps 'moving' members**



Rajya Sabha Chairman M Venkaiah Naidu (pictured) on Friday pulled up members, including some ministers, who were moving about in the House after a vote was announced on the matter of referring the Right to Information (Amendment) Bill to a select committee. The Opposition complained about ministers "trying to influence MPs" during the process. "People in authority must be careful... Even individual members are not supposed to move this side or that side... If they want to talk to any member, they are at liberty to talk to them before the voting process starts and, that too, preferably outside the House," Naidu said. The voting process on the Bill had ended in a furore after Bharatiya Janata Party member C M Ramesh was seen collecting voter slips from Telugu Desam Party MPs. Only officials are supposed to collect the slips, as per House rules.

**New direction**

Is the Trinamool Congress working on a strategy to rope in party whole-timers, a la Communist Party of India (Marxist) and the Bharatiya Janata Party? A party meeting to be held today (July 29) at Kolkata's Nazrul Mancha has kicked off speculation that West Bengal's ruling party might be working in that direction. All MLAs, district- and block-level leaders are expected to attend the meeting. The state has 77,000 booths. Word is that Trinamool will appoint four whole-time members per booth. The target is to appoint 300,000 such members, who will not only identify and recruit new members but will also contribute to the party's social media strategy.

**Powerless in MP**

Madhya Pradesh health minister Tulsi Silawat was left red-faced when the electricity supply tripped during his speech at the Academy of Administration in Bhopal last week. Silawat was presenting his ministry's action plan pertaining to antimicrobial resistance. As the venue plunged into darkness, officials fished out their mobile phones to turn on some light. Pictures of people switching on their mobile flashlights went viral in no time. This is the second time in a month that Silawat faced such a situation. In June, when he was discussing the problem of outages in hospitals, the electricity supply had tripped. Indeed, since the Congress government took charge of the power-surplus state in December 2018, unscheduled cuts have become the order of the day.

# Rating agencies: Derated and now berated

The onus is on the CRAs to come out clean or face the wrath of the markets and live in shame



### BANKER'S TRUST

TAMAL BANDYOPADHYAY

The findings of the interim report of a forensic audit by Grant Thornton, an audit, tax and advisory firm, engaged by the board of the disgraced Infrastructure Leasing and Financial Services Ltd (IL&FS) — detailing the gifts and favours that the senior professionals of credit rating agencies (CRAs) have allegedly enjoyed to keep a rotting company on a high pedestal — exposed the soft underbelly of India's rating industry.

Till the findings of the report trickled down in the media, the CRAs were criticised for basking in the cool comfort of their offices, oblivious of the ground realities; they miserably failed in their due diligence and acted only when the writing on the wall was visible to the entire world. The alleged corrupt practices indulged in by the rating officials add a dirty dimension to this.

Both IcrA Ltd and Care Ltd have asked their chiefs to go on leave till the investigations are complete. India Ratings and Research Pvt Ltd has said the senior

director in its parent firm, Fitch Singapore, is no longer an employee even as Crisil Ltd has distanced itself from the IL&FS saga, saying it has nothing to do with it.

Let's take a look at the cultural roots of the CRAs. The big three — Crisil (1987), IcrA (1991) and Care (1993) — have all been promoted by now-defunct development financial institutions — ICICI Ltd, IFICI Ltd and IDBI, respectively. The secretariat of then ICICI chairman H T Parekh followed an informal process of accepting gifts. Every Diwali and New Year gift was numbered and kept in the conference room of the office till they were distributed through a draw among peons, gardeners, canteen boys and sweepers. The gifts were also sent to an orphanage at Girgaum, southern Mumbai. And, of course, the chairman's secretariat would send a "thank you" note to all senders, requesting them not to continue with the ritual in future. I am not aware of the processes followed by IFICI and IDBI.

In the beginning, the bosses of all the rating agencies represented the sponsors and eminent professionals were on their boards. The rating committees were constituted with members of the boards and care for ethics was an obsession. The late R Ravimohan, former MD and CEO of Crisil, once remarked: "Credibility is the most valuable asset on our balance sheet; unfortunately accounting standards do not permit recording and valuing the same."

Other rating agencies such as Acuité Ratings & Research Limited (formerly SME Rating Agency of India Ltd, pro-

moted by Small Industries Development Bank of India and Dun & Bradstreet in 2005), Brickwork Rating India Pvt Ltd (2008), and India Ratings and Research (in early 2000 Fitch bought stake from Dun & Bradstreet Corporation and raised it gradually) by and large adopted the culture of the big three.

International tie-ups and technical assistance — Standard & Poor's for Crisil, Moody's Investor Service for IcrA, Department for International Development, UK, for Acuite Ratings and Fitch group for India Ratings — have given further impetus to governance and transparency. The boards of agencies have adopted governance policies defining conflict of interest, disclosure norms and rules for accepting gifts, favours and gratifications with predetermined monetary value. All these are documented and a part of the employee engagement rules and ethics policy; the compliance officers (usually the company secretaries) are tasked with their implementation.

Apart from chocolates and dry fruits, office utility articles such as calendars, pens and pen stands, pots and plants, coffee table books feature in the permissible list but the employees are expected to return the gold-plated miniature Ganesha and Lakshmi idols, Montblanc pens, smart phones and iPads. Incidentally, the salary and emoluments (including stock options) of rating agency employees are on a par, if not better, than what the banking and finance industry offers.

Although the Grant Thornton report deals with only the IL&FS case, people familiar with the industry say at least for a few CRAs, the internal norms are relaxed and it is not difficult to find people from the rating fraternity enjoying cruise trips in Greece, Spain and Alaska. The



not-so-senior managers enjoy free stays at cottages in beach resorts (Goa), tea plantations (Coorg), wildlife sanctuaries (Jim Corbett National Park) and hill stations (Shimla), courtesy the rated entities.

Rating is a process-driven exercise; direct interactions with the entities being rated are restricted. As the rating symbol captures "timely payment of interest and principal", the emphasis is on free cash flows and the rated entity's ability to service debt obligations (both interest and principal). Typically, the CRAs follow an unwritten rule that a minimum of two people meet their clients (to weed out any subjectivity in their analysis) and the focus is on business model, competition and professional competence apart from parentage and succession planning among other things, while evaluating companies raising debt.

For all rating exercises (new as well as surveillance), apart from a primary analyst, there is a principal analyst and a relationship head as well as a sector specialist involved. All issues are discussed before a presentation is made to

the rating committee of directors for considering a fresh rating and continuation/revision (upward or downward). Now, it seems such a process could be sham and ratings can be influenced.

At the beginning of the century, for expanding their market share, a few CRAs had introduced an unsolicited exercise in the garb of visibility ratings or shadow ratings. They rated companies based on information available in the public domain. Such ratings were first informally shared with the companies and only after they were accepted, the rating exercise would start with an official mandate. The products fizzled out after the market regulator came down heavily on them even though it has been a global practice. That may be a not-so-proper business practice but the current problem is much deeper.

What needs to be done to cure the maladies? Should the salary and stock options of CEOs be ploughed back if they are found guilty? All raters need to go for Sadhguru's inner engineering (internal cleansing process) through a forensic review to purge the system if they want to address the huge trust deficit between the CRAs and the investor community.

Indeed, banks, NBFCs and other lenders have their own internal rating systems but they also need the certificates of the raters. Even the Insolvency and Bankruptcy Code stipulates investment grade rating from two agencies to move ahead with a resolution plan for bad debt of at least ₹500 crore and more. The onus is on the CRAs to come out clean or face the wrath of the markets and live in shame.

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# Tech that can silence mutations

It holds the potential to change the therapeutic landscape for many neurological and non-neurological conditions in future



### TECH-ENABLED

DEVANGSHU DATTA

A heartbreaking post by Rohan Seth, a computer scientist based in San Francisco, is doing the rounds on social media. Seth and his partner, Jen, had a child, Lydia, about six months ago. Soon after birth, she started having seizures. They discovered after many tests that "a tiny random mutation in a critical gene is affecting her brain function, causing severe disabilities and suffering".

Faced with this situation, Jen and Rohan did their research and decided to "open source their baby in the hopes of saving her, and millions like her". They set up a non-profit and raised \$1.5 million to fund research. There is hope based on a new procedure and the parents hope there could be treatment within months.

The Seths discovered that there are only two other persons known to have exactly the same genetic mutation. The nucleotide bases of DNA (deoxyribonucleic acid) are adenine, thymine, cytosine, and guanine (A, T, C, G). In Lydia's DNA, the "A" was replaced by a "G" at position 683 of the gene KCNQ2.

There are six billion-odd characters in any human's DNA and this sort of "typo", as Seth calls a mutation, can occur anywhere in that string. So conventional tests don't pick it up. While negative mutations affect millions of people worldwide, any given mutation may be so rare that no pharma company will bother to research for a poten-

tial treatment.

The Seths discovered that there is a technology called antisense oligonucleotides (ASOs) that can silence such mutations. The first approved ASO drug only became commercially available in 2016. It is possible to create an ASO drug that exactly targets a specific mutation. The mission of the Lydian Accelerator is to create an open source database of ASO research.

Genetic expression occurs via a process where the DNA transmits information to the ribosome via what's known as Messenger RNA (mRNA where RNA stands for ribonucleic acid). The ribosome is a sort of large molecular factory, which is found in all living cells. It uses the information it receives from mRNA to create proteins. Antisense therapy targets the mRNA to prevent information from a mutated gene from being expressed in this fashion by suppressing the message from the DNA to the ribosome.

Oligonucleotides are short fragments

of nucleic acid. In antisense therapy, the misbehaving gene is first identified. Then an oligonucleotide is chemically synthesised to neutralise the information transmitted to the mRNA by that mutated gene. This is very specific, accurate targeting, that can create designer drugs targeting just one individual.

As with DNA, mRNA genetic information is in the sequence of nucleotides, which are arranged into codons consisting of three base pairs each. The oligonucleotides physically bind to mRNA and can neutralise instructions for creating a specific protein. The treatment has been used to treat a wide range of diseases including thalassemia, retinitis, muscular dystrophy, cancers, HIV, AIDS.

The effects of ASOs in influencing RNA processing protein expression were discovered over two decades ago. The antisense effect of a synthetic oligonucleotide sequence was first demonstrated in the late 1970s by Zamecnik and Stephenson.

However, the progress in using these technologies has been slow. The US Food and Drug Administration approval for the commercialisation of the first ASO, Vitravene (for cytomegalovirus retinitis) came through in 2016. It was as recently as 2018 that Dr Timothy Yu at Boston

Children's Hospital created the first designer antisense drug targeting an individual. But approvals of ASOs for the treatment of spinal muscular atrophy and duchenne muscular dystrophy have been received.

This technology holds the potential to change the therapeutic landscape for many neurological and non-neurological conditions in the future. But its expensive and potential side effects must be studied. The Seths could provide an impetus through their NGO.

As they say, as computer scientists, they believe in open platforms. "By open sourcing the processes, tools and data from the first few N-of-1s, we can empower any institute to create one. We can then build a shared database of efficacy and safety data — anyone performing an N-of-1 (creating a designer drug for an individual) should be able to tap into this repository as long as they contribute back with their data. With more data, we may be able to use algorithms to reduce or even eliminate lab work that constitutes the bulk of the costs today. With each treatment, we can reduce the time and cost for the next one." This could be an unusual concatenation of cutting edge technology, and crowd sourced research disrupting the traditional model of drug development.

### LETTERS

#### Unsolved mystery

This refers to "Wrapped in mystery" by Nivedita Mookerji (July 25). The speed at which Oyo Rooms and its founder Ritesh Agarwal are moving should draw the attention of regulators, financial institutions, investors and above all, the appropriate wing of the government. The validity of the WhatsApp message talking about "another financial scam waiting to explode" may not be justified as of now due to lack of evidence and may be brushed under the carpet in days to come. The mystery behind the speed of growth is really adding one layer above another.

The name of one investor — Lightspeed Venture — is also interesting. The speed of room acquisition, share buyback and IPO planning is raising the eyebrows of market watchers and the common people. Most surprising is that Oyo claims to be one of the largest hotel chains in the world with virtually negligible physical assets creation. I completely agree with Ms Mookerji that the modus operandi of the Oyo group and its founder has really left the audience perplexed. Let us not forget the rise and fall of Kingfisher Airlines, Barings Bank, Jet Airways and very recently, Nirav Modi and Mehul Choksi.

**Sanjoy Dutta** Kolkata

#### India calls the shots

This refers to "Why does India resist mediation on Kashmir?" by Aakar Patel (July 26). The topic has gained attention because of a comment by US President Donald Trump during Pakistan Prime Minister Imran Khan's visit to Washington. The columnist has come to the conclusion that the message sent abroad is that India fears outside diplomatic intervention due to some perceived weakness. The actual message sent out is that India is the decision-making power in this region and we do not need anybody to complicate the existing situation.

**J K Achuthan** Ernakulam

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## Risk to federalism

Finance Commission should not carve out a separate fund

In a recent decision by the Union Cabinet, the terms of reference of the Fifteenth Finance Commission were amended, so that the needs of defence and internal security be set aside from regular expenditure. In the course of extending the Commission's term, the Cabinet added the following to its mandate: To "address serious concerns regarding allocation of adequate, secure and non-lapsable funds for defence and internal security of India".

This has correctly been seen as an attempt by the Centre to occupy more fiscal space. Article 280 of the Constitution requires the Commission to be the overall judge of how taxes are distributed, and Article 266 implies that the Consolidated Fund of India is a shared pool for all national priorities. Setting aside a fund purely for defence, which is the natural end point of the Cabinet's demand from the Commission, would act against this basic constitutional principle. It would sequester defence spending and give the Centre more space to spend on its own political priorities at the expense of the states. At a time when there is a quiet fiscal crisis brewing, thanks to the underperformance of the goods and services tax, this is not a welcome development.

It is true that defence allocation, in particular, has been a source of constant worry in past years. It has effectively been shrinking as a percentage of gross domestic product. Worse, a large part of the expenditure goes to fund the wages and pensions bills, along with other current expenditure. The capital budget for defence is in any case too small, and much of it is taken up with tied expenditure — purchases already agreed upon, for example. The amount left for modernisation initiatives is too small. But short-circuiting the Constitutional provisions and shrinking the resource for states are not the answer to this conundrum. No one item on the Central List of the Constitution should be given priority over the State List and the Concurrent list in this manner. It is up to the Union government to decide how much it sets aside for defence from the revenue available to it. If it has not been doing so enough in recent years, it should reassess its overall expenditure, and not ask for the pool of taxes available for division be altered at the expense of states that have been more fiscally responsible.

The carve-out might also include spending on internal security. The paramilitary forces in India have been an exception to recent trends, growing in size, number, and expense. This cannot continue forever, especially as left-wing extremism is less virulent than it has been at times in the past decades. The Commission would do well to recognise the extreme political danger that a carve-out at the request of the Centre for internal security and defence poses to the federal structure of the country. If such a security-specific fund is created, it should not affect the revenue that goes to the states. The Centre should pay for it itself. Anything else would undermine the constitutional framework and might lead to serious problems in the coming years.

## Reforming agriculture

Farming needs to be made profitable

The proposal to link the allocation of Central funds to farm sector reforms in states, discussed at the first meeting of the chief ministers' committee on transforming agriculture, has many sides and needs careful examination before the final call is taken. While it is true that several well-judged farm sector reforms initiated by the Centre have failed to make much headway because of states' apathy, the denial of funding on this count may prove counterproductive, besides undermining the spirit of federalism. If the states' disinterest in Centre-sponsored reforms and other initiatives is owing to their own better plans to achieve the same objective, squeezing funds would be unfair. But if it is attributable to administrative lethargy and inefficiency or, worse, politically motivated one-upmanship, as is sometimes the case, harsher fiscal steps may not be unjustified.

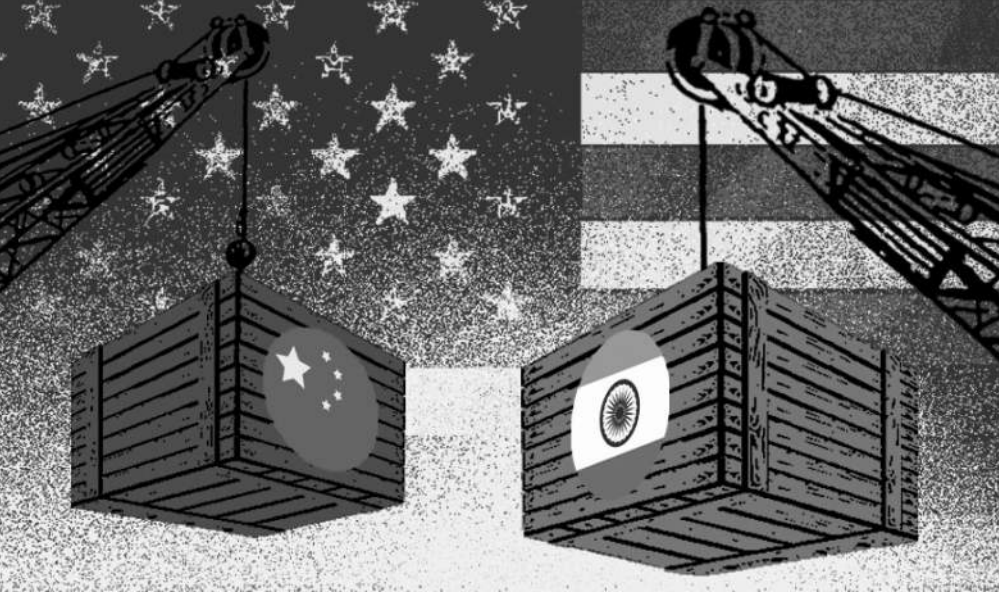
Indeed, the idea of leveraging Central finances for nudging states to hasten reforms is not new. Even the National Institution for Transforming India (NITI) Aayog had advised the agriculture ministry in 2017 to tie up a part of the grant under the umbrella farm development scheme Rashtriya Krishi Vikas Yojana with the implementation of farm sector reforms. However, the proposition was not pursued due to the fear of backlash from state governments. But if some chief ministers are themselves veering round to this view, it may be worthwhile to try it out, even if on a selective basic. A beginning can be made to push reforms in fields such as agricultural marketing, land leasing, contract farming, crop insurance, and agricultural credit.

Another possible, albeit hard to execute, way to circumvent the states' indifference towards the Centre's farmer-oriented agenda could be to shift agriculture from the State list to the Concurrent List of the Constitution's Seventh Schedule. This would empower the Union government to play a greater and more decisive role in the development of agriculture without significantly diluting the powers of the state governments. Such a statutory translocation of agriculture was suggested by the M S Swaminathan-headed National Commission on Farmers in its fifth and final report in 2006. Of late, the Dalwai committee's report on the issues related to doubling farmers' income by 2022, presented to the government in September 2018, also favoured putting agricultural marketing on the Concurrent List.

However, the amendment to the Constitution for this purpose would require the support of two-third members of both houses of Parliament and an endorsement by a requisite number of state legislatures. It might be a tall order, but it would certainly not be unprecedented as such statutory amendments have been carried out in the past as well. Subjects like education, forests, and wildlife protection were moved from the State List to the Concurrent List through the 42nd amendment of the Constitution way back in 1976.

The substantive issue, really, is to carry forward some vital and, more importantly, need-based reforms in agriculture to restore profitability and mitigate farmers' lingering financial woes. Exit avenues also need to be created to let farmers quit farming if they intend to do so to improve their livelihood prospects. The chief ministers' panel can legitimately be expected to come out with practically feasible plans to rejuvenate the country's farm sector.

ILLUSTRATION: AJAY MOHANTY



## Is China's loss India's gain?

To assess developments associated with the trade war, the data to focus on is the US import of goods from both the countries

US President Donald Trump has taken the US into a trade war with China. The early evidence suggests some gains from this for India. The deeper gains will arise, however, through the FDI decisions of the boards of global companies, which will play out over time. For India to make the best of this situation, we need to become more of a mature market economy, and play fair by the rules of the game of globalisation.

In a China-India comparison, the Chinese economy is bigger and the Chinese policy establishment is more capable. China has graduated to making sophisticated goods, such as computer equipment, which India does not make. India's exports, so far, look more like those of a developing country. As a consequence, we may expect that the US-China trade war might not yield significant gains for India.

In order to assess the developments associated with the trade war, the data to focus on is the US import of goods from both countries. India does well on services exports to the US, but we will keep those out of the analysis as the US-China trade war is primarily about goods. The latest data, for the month of May 2019, shows that India's exports to the US were \$5.6 billion, China's exports to the US were \$39.3 billion and the total import of goods into the US was \$220.8 billion. India's value is, of course, much smaller than that of China.

How have the exports of these two countries been changing as a consequence of the US-China trade war? The highest ever value of China's share in US imports was in September 2015, at 23.87 per cent. From that high, there has been a decline to 17.78 per cent in the latest data, which was May 2019. Just one year prior to

this, in May 2018, China's share was 21.5 per cent.

From the peak of September 2015 till the latest reading of May 2019, China's share in US imports has declined by 6.09 percentage points. This is a big change. Over this period, India's share in US imports went up from 1.92 per cent to 2.54 per cent. This is a gain of 0.62 percentage points. We may say that about a tenth of the share ceded by China has accrued to India.

To what extent are these changes about the recent trade war, and to what extent is there some deeper long-term phenomenon going on? The graph (above)

shows China's exports of goods to the US divided by India's exports of goods to the US. Chinese exports were 2 to 4 times larger than India in the late 1980s, and this went up to 16 times bigger by 2007.

Over the last decade, the ratio has improved from India's point of view. Over and above this long-term process, it does look like the latest few data points have some gains for India in response to the US-China trade war.

How best can India play the emerging US-China trade conflict?

The first point to emphasise is that most global trade takes place within multinational firms. When Walmart grows deep roots in India, Walmart will export more from India. For India to do well in exporting, we need global firms to commit to India, on a greater scale, and we need Indian multinationals to flourish. These effects will necessarily play out slowly. When a US-China trade war erupts, in the short run, global firms do not change course by much. But in the medium term, boards of global firms are constantly looking at the countries in which they operate and making



### SNAKES & LADDERS

AJAY SHAH

## Consensus or confrontational politics?

Sheila Dikshit, Delhi's three-term chief minister who passed away on July 20, must be remembered for her politics of consensus and negotiated settlement. This is even more important in today's age of highly polarised politics. It is also important if we consider that the objective of a government is to ensure delivery of development. And this is not possible without the ability to manage the contested realities and seek a collaborative solution. For me, this is the real art of politics. Unfortunately, we seem to be losing this art as hate and loud noise take over the airwaves and our world.

My encounter with Sheilaaji (as she was known) began with a fight. In the late 1990s we were in the Supreme Court, arguing that Delhi's public transport must switch to cleaner compressed natural gas (CNG) fuel to combat its then deadly air pollution. This had become adversarial and contentious. The Union government was dead against it; the diesel lobby was arguing that CNG was explosive and untested. The Delhi government — then headed by Sheilaaji — was dragging its feet to make the transition. Queues at petrol pumps were getting longer and longer as gas was not being delivered; buses were being burnt to show how CNG would not work. In the Supreme Court, the then solicitor general of India, Harish Salve, was hauling up the government for its deliberate inaction. The top court was getting more and more incensed and called for contempt proceedings to start against the Delhi chief minister.

Then all this changed. Sheilaaji walked into the court personally. She didn't stand on ceremony; she didn't join the acrimony. She just ensured that orders were to be followed. As they say, the rest is history. We worked closely with her government through this period of transition to CNG. She didn't blink when the going was tough. She had the ability to make her bureaucrats deliver, not as sovereigns, but by including words and ideas from the "outside". She joined worlds effortlessly and with grace. This is another art in politics we are losing.



### DOWN TO EARTH

SUNITA NARAIN

Bus Rapid Transit System (BRT), it was because she gave a chance to seemingly impossible ideas. It is our collective inability to design a system for the complexity of Delhi — one that would negotiate with the different road users and not antagonise needlessly — which made the system fail. But she again did not give up on ideas. She dismantled the notorious Blue Line bus service, even though many politicians owned such buses. She supported the purchase of a new gen-

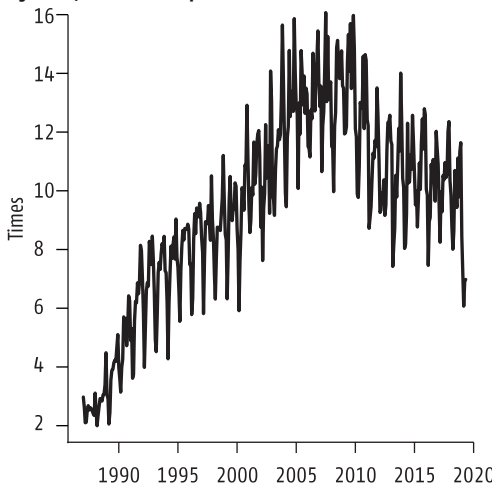
In his new biography, *Bagehot: The Life and Times of the Greatest Victorian*, James Grant follows this pattern, burnishing his subject's reputation but offering a somewhat limited appraisal of Bagehot's achievements.

Mr Grant is a biographer of Bernard Baruch and John Adams, and the founder and editor of the cheeky and stylish Grant's Interest Rate Observer. The characterisation that the highbrow Labour Party politician Richard Crossman (another Bagehot devotee) bestowed on Bagehot's writing — a "mixture of rollicking cynicism and cool analysis" — applies to Mr Grant's own brilliantly contrarian criticism in the Interest Rate Observer, *The Financial Times* and elsewhere of market recklessness, bankers' irresponsibility and (to Grant) their concomitant, the expansive monetary policies of the Federal Reserve that have defined the booms and busts of the past 30-odd years.

This biography, though, takes wing only when it treats Bagehot's role as a banker

### BIG OPPORTUNITY

Chinese exports to the US were 2 to 4 times larger than India in the late 1980s. This went up to 16 times by 2007, and has improved over the last decade



changes based on their judgement about the countries that offer a better economic environment.

We have to get into the mind of the boards of global firms, which are grappling with the problem of their over-exposure to China. What can we do to become more attractive to them?

Improving India's attraction as an FDI destination is about the familiar issues of labour law, infrastructure, and taxation. Of these, taxation has become a particularly important problem. Tax policy and tax administration is a major concern for global operations. For India to be integrated into global supply chains, goods should seamlessly move into India, and then get re-exported. This requires removing all customs duties, establishing a goods and services tax (GST) -on-imports and having zero-rating of exports. It also requires well-structured operational procedures and a well behaved tax administration. The use of raids and imprisonment deters private persons from operating in India.

India now has the highest income tax rate for corporations in the world, and a source-based taxation system. This needs to shift to a residence-based taxation system, and an income tax rate for corporations (all inclusive) of 20 per cent.

India is seen as a difficult place to operate in, on account of policy risk. There is a danger of sudden change, e.g in customs duties. This requires deeper reform of the policy process. The process of making laws and regulations requires greater consultation, cost-benefit analysis, and introduction of rule changes from dates well into the future.

We should rein in our sense that China's loss is our gain. India has a lot to lose in the decline of a rules-based world of globalisation. We now earn ₹4 trillion per quarter from the export of services and ₹6 trillion per quarter from the export of goods. To make this more physically interpretable, we earn ₹0.44 trillion every calendar day through the export of goods and services. We already have a lot at stake in a globalised world. Looking into the future, it is likely that policy reforms in India (on the issues sketched above) will yield considerable growth of exports from India. We will have more at stake in the future.

If Trumpism becomes the new normal, we will be at the receiving end of it at future dates. India's stance in international relations should emphasise the gains from a rule based world of open borders, where there is a low risk of new barriers to globalisation coming up.

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## Resurrecting the 'Greatest Victorian'



### BOOK REVIEW

BENJAMIN SCHWARZ

Walter Bagehot (1826-77) — the British literary critic, banker, journalist, political sociologist, analyst of finance, social psychologist and editor of *The National Review* and *The Economist* — has never lacked for admirers. His devoted friend George Eliot concurred with the verdict of another close friend, Lord Bryce, that his "was perhaps the most original mind of his generation." Gladstone confided that both Liberal and

Conservative governments so prized Bagehot's financial acumen that they looked to him as a "supplementary chancellor of the Exchequer." His posthumous idolaters have included Woodrow Wilson (who defined Bagehot's role as nothing less than "to clarify the thought of his generation"); Herbert Read, the modernist poet, anarchist philosopher, art critic and literary critic, who pronounced Bagehot's literary criticism "the best of its time" save for Matthew Arnold's; Jacques Barzun, the intellectual historian, who for decades championed him as "the greatest Victorian"; and Ben Bernanke, who, in a memoir of the most recent financial crisis, cited Bagehot more often than any living economist. Nevertheless, Bagehot is fated to be best known for not being better known.

This limbo probably owes something

to the uncertain pronunciation of his name (most say "Badge-it"; some insist on "Bagot") and more to the wide range and seeming incongruity of his fields of expertise, as the disparate assortment of his celebrants suggests. Containing multitudes, Bagehot has been impossible to pigeonhole. Those who examine, say, his comparison of the role of the provinces in *Tristram Shandy* and the novels of Thackeray may well be unaware of *Lombard Street*, his tour de force anatomisation of the psychology of finance and banking panics and of the sociology of the London money market. "No book on banking," John Maynard Keynes wrote, "has ever attained such a position — an undying classic" imbued with "the glamour of intense reality," it "is a perfect example of a certain kind of English writing, and its truth of human nature."

Those who champion his startling elu-

cidation of the social and psychological dimensions of the Crown and the House of Lords in *The English Constitution* tend to form a different constituency from those who look to his pioneering exploration of evolutionary political sociology in *Physics and Politics* (which William James pronounced a "golden little book"), and from those who see his most enduring contribution to be the creation of a new prose style — cool, ironic, epigrammatic, allusive, balanced, sometimes slangy — that remains part of the mental furniture of Oxbridge, Britain's Civil Service and what used to be called Britain's "higher journalism."

While a full appreciation of Bagehot has been hobbled by his polymathic attainments, he has nevertheless been fortunate in his devotees — even if, for the most part, each has been able to illuminate only specific aspects of his career and his genius.

and financial journalist. That these are the very aspects of Bagehot's work that have been relatively neglected by most scholars, who have tended to concentrate on his literary, political and sociological oeuvre, might be reason enough to commend Mr Grant's excellent if uneven biography. Bagehot scholarship, however, isn't accretive, and the 1959 book *The Spare Chancellor*, by the worldly British journalist Alastair Buchan, remains the most astute, elegant and historically informed assessment of Bagehot's entire life and work — including his participation in and analysis of the powerful and precarious world of finance.

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### BAGEHOT

The Life and Times of the Greatest Victorian

James Grant

WW Norton & Company; \$29.95; 334 pages