

Opinion

TUESDAY, AUGUST 27, 2019



TACKLING HURRICANES

President of USA, Donald Trump

They start forming off the coast of Africa, as they're moving across the Atlantic, we drop a bomb inside the eye of the hurricane and it disrupts it. Why can't we do that?

Anti-plastic vision shouldn't become a waste of efforts

Ban on plastic hasn't worked; the focus should perhaps be on managing plastic waste better

THE PRIME MINISTER has the right idea in calling for a ban on single-use plastics in the country. But, the sobering truth is that this has proved more difficult to implement than it sounds at the first war cry. For perspective, 25 of 29 states already have total/partial plastic bans, and yet, it continues to be a menace big enough for the prime minister to try and raise awareness about. Even though India isn't a big plastic polluter (given its low consumption level), the plastics industry is slated to grow at a steady rate of 10.5% annually over FY15-FY20. And, it is true that developed nations, including the US, have treated the developing world as dumping grounds for their waste, including plastic waste. But, the fact is that mismanaged plastic waste in the US, as per an analysis by *Science* was just 0.9% of the total waste generated in that country versus nearly 2% for India. While the 2% figure seems small, India generates 33.1 million pounds of plastic waste every day, of which only 19.8 million is collected and recycled.

The Union government, in March last year, amended the Plastic Waste Management Rules 2016, aiming to completely phase out single-use plastics by FY20. That the Indian plastic industry, which employs around 4 million, will bleed jobs once a ban is enforced aside, as long as consumers aren't given alternatives that are affordable, easily available, and sustainable in the long run, expecting this anti-plastic "revolution"—with a summary ban, if this is envisioned—to take off is just building castles in the air. Maharashtra's experience—the state is the largest generator of plastic waste in the country—shows how ground realities foil the best intentions. The state banned single-use plastics last year, with hefty fines for offenders; but, just days before the ban came into effect, there was little on-ground preparedness, as *The Indian Express* had reported at the time. Not enough had happened to make sustainable alternatives to plastic carrier bags available to the public. And, the "buyback" policy that the state government had come up with to encourage consumers to return plastic bottles also fell flat because there was absolutely no clarity on its operationalisation. Consequently, the state had to dilute its ban in phases, largely because of the backlash it faced from both industry and individual users of plastic in the state.

Substituting single-use plastics—especially plastic bags—is easier said than done. Cotton bags, long thought of as a more environment-friendly substitute, may not be all that they are worked out to be, given the environmental footprint of their manufacture, as recent research shows. Cloth/jute bags, corn-starch bags, disposable plates and cutlery of soft/re-purposed wood, etc, are all talked about, but are either more expensive compared to the plastic-product they are expected to replace or less easily available. For instance, the installed capacity for non-export jute in the country is 2,700 tonnes per annum versus 10.3 million tonnes for plastic, a significant chunk of which caters for products that jute products can functionally substitute. With such a massive gap, phasing out plastics seems very difficult. Given how poorly recycling efforts, from collection to actual recycling/re-purposing/reuse, are monitored, India's plastic problem poses a daunting challenge. Often, a high cost of use at the consumer level—much like what Japan imposes—is proposed as an alternative to bans, but, given the lack of substitutes, it will be a *de facto* ban. So, to tackle the emerging plastic menace, India must not only work on encouraging cheaper, readily available substitutes but also get its act together on managing plastic waste better.

Killing access to credit

Madhya Pradesh's move leaves tribal folk more vulnerable

ON PAPER, THE amendment to Madhya Pradesh's Anusuchit Jan Jaati Sahukar Viniyam 1972 that the Kamal Nath government has brought seems noble. After all, governments must protect the marginalised from exploitation and usury—there have been enough reports, this year alone, of bonded labour to suggest that such exploitation hasn't been fully eradicated. The amendment not only waives off all existing loans from unofficial sources for tribal people in the state but also provides for jail-term of up to three years and a fine of ₹1 lakh for private, unlicensed moneylenders who try to recover the loan forcibly. Even licensed moneylenders are no longer free to negotiate the interest rate with the borrower. But, not only does the Nath government miss the woods for the trees in the matter, it, in fact, leaves tribal people in the state far more vulnerable than before.

Madhya Pradesh ranks 25th out of 36 states and Union Territories in the Crisil Inclusix 2018 report. While it does 'above average' on credit penetration, it is 'below average' on branch penetration; only 37% of the bank branches in the state were in rural areas, at the end of June 2018, and each bank office was serving 10,209 people against the national average of 9,280; commercial banks were serving 14,781. While 17 out of the state's 51 districts have significant tribal population, just four of the 17 had an 'above average' showing in Inclusix. It is, thus, likely that the bulk of credit penetration from formal sources is happening in the non-tribal districts in the state. But, while the state needed to crack down on usurious rates and linked exploitation, it has instead adopted a solution that will mean moneylenders simply stop lending to tribals—and the banks can't be faulted for this—the waiver means a 'from the frying pan to the fire' fate for Madhya Pradesh tribals. It is also unclear whether the waiver extends to all informal loans, including loans from relatives. If it does, it foments not just trouble within the community, it hurts tribal households that have lent money, too.

The government could have simply opted for harsh punishment for forced recovery and usury/exploitation while increasing the reach of formal finance, not just through bank penetration but also by shifting to direct-cash-transfers for various government benefits. Even if banks can't treat these funds as some manner of assurance of recovery, it would have allowed them to screen and target tribal households showing responsible financial behaviour for extending credit. A summary waiver, on the other hand, means not just increased vulnerability but also increased likelihood of default on loan repayment from other sources in the hope of a bailout/waiver.

Golden OPPORTUNITY

PV Sindhu's rise should inspire India to take right route on nurturing more such sports greatness

PV SINDHU, India's ace shuttler, created history by becoming the first Indian ever to win gold at the World Championships. This was her third attempt at the title. While Sindhu had cemented her place in Indian sports history when she bagged the silver at the Rio Olympics in 2016, her latest victory has raised hopes of the first Indian gold in badminton in the 2020 Olympics. Sindhu's record of success says as much about the state of badminton in the country as her own individual mettle. Her coach, Indian badminton great Pullela Gopichand, had set up a world-class academy with a grant from the government in 2004, and has been instrumental in raising the level of Indian badminton. His pupils, Kidambi Srikanth, Parupalli Kashyap and Saina Nehwal, have all secured top positions in world championships. But, at government-run sports academies, there is little to speak of.

While corruption is a significant reason for India's poor show, another important one is the lack of infrastructure. The number of government-owned sports facilities in India are limited, and even those are not well maintained. Except for cricket, not much attention has been paid so far to sports. An IndiaSpend analysis reveals that India spends roughly a third to a fourth of the money spent by the UK, which won 67 medals, compared to India's two, in the 2016 Olympics. Moreover, while the country spent ₹750 crore on sport-specific federations, training centres, coaches and other infrastructure between 2012-13 and 2015-16, spending on athletes totalled ₹60 crore. Per athlete spending for the country was far less than what some foreign universities spent on their athletes. If India needs more Sindhus, it must give more Gopichands the requisite support to nurture future champions.

● RATE CONUNDRUM

LOWER RATES HELP LOWER THE COST OF BORROWING, BUT BANKS HAVE TO CONSIDER GROWTH IN DEPOSITS. THIS PREVENTS THEM FROM RESPONDING THE WAY RBI WOULD LIKE

Difficult to sync lending rates with repo rate

MADAN SABNAVIS

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Views are personal



IT IS NOW almost axiomatic that whenever the MPC convenes, there will be a rate cut in case CPI inflation is reigning at less than 4% and the risk factors are minimal. At present, oil price is down, and there is little possibility of a spike as every time supply comes down from the cartel, the US tends to provide the required substitution. Besides, the world is moving towards less oil consumption. The monsoon has turned normal and, while there can be marginal shortfalls, it is unlikely that prices will shoot up. Yes, prices of vegetables can create panic at times due to the recent flooding in several parts, but that would be temporary in nature.

The important question is whether or not we have been relying too much on monetary policy for growth, and lost the plot along the line. The economy has been stagnating as several sectors show declining growth and job losses. The government has chosen to stick to fiscal prudence and sought to revive animal spirits through some 'talk'. The recent measures announced by the FM are more in the nature of addressing pain points of industry, like auto or SME, or banks and not any additional fiscal outlays. The withdrawal of the surcharge on tax to be paid by FPIs is probably the only one which has fiscal implications. But, plain talk, not backed by financial resources, has not worked in the last three years. That is the difference between 'RBI talk' and 'government talk'. 'RBI talk', also sometimes loosely called 'open mouth operations', has worked to cool the currency and, at times, interest rates that are market determined. But, when it comes to the government, industry does not seem to be convinced and is waiting for a 'delta' to flow in the form of additional expenditure announcements. This is not happening.

Captains of industry have been asking for rate cuts more out of habit, and RBI and MPC have been obliging with alacrity. When it was 25 bps, they argued that it was anaemic and some-

thing more potent was required. Last time, it was 35 bps and, hence, industry should be happy. RBI and the government have both been haranguing banks to lower rates, and the famous epigram of all discussions in the media is that the 'transmission is rigid'. Let us see how these numbers have moved in the last one year or so.

The repo rate has come down by 110 bps in the last year, ending August 9, 2019. The first point of action has to be the deposit rate as it feeds into the MCLR, which becomes the indicative rate for borrowers. The one year deposit rate has moved from 6.25-7% on August 10, 2018 to 6.35-7.3% on August 9, 2019. The mid-point rates have moved from 6.625% to 6.825%. The mid-point savings bank rate has, on the other hand, come down from 3.75% to 3.375% in this period. The weighted average rate on term deposits has gone up from 6.72% in June 2018 to 6.84% in June 2019. Quite clearly, banks are cautious here as lowering deposit rates in general will affect the supply of funds and, given that deposits are 76-78% of total liabilities, lower repo rates do not necessarily translate to lower deposit rates.

Let us look at the lending side. The MCLR has moved up from an average of 7.9-8.05% to 7.9-8.4%—a mid-point increase from 7.975% to 8.15%—at a time when the repo rate has been lowered. The WALR on new loans has moved from 9.45% to 9.68% (June to June), while that on outstanding loans has increased from 10.26% to 10.43%.

The question is why lending rates

are not coming down, when policy rate has fallen sharply in the last year? First, MCLR is a function of the deposit rates and, if the latter does not come down or increases, it does not really point to lower lending rates. Second, even if the MCLR comes down, the effective rate for customers may not come down if credit risk perception is higher. And, at times when the economy is in an acknowledged state of slowdown, with corporate sales growing at an anaemic rate of 5% in the first quarter, it would be incorrect not to price in this risk when lending to most clients. That is why the WALR has gone up during this period. Therefore, the issue of transmission must be left to banks, rather than being decreed from above, as interest rate is the price for capital which should ideally be the reflection of demand and supply. Supply is restricted by deposits growth while demand is screened by banks, based on quality, where credit risk matters. On the demand side, it should be realised that it has not kept pace as there is still surplus capacity with industry. Also, private sector investment in infrastructure is still limited and, hence, comes in the way of demand for funds.

The market reaction to interest rates has, however, been amazingly proactive. The 10-years GSec has moved down by 110 bps between August 10, 2018, and August 9, 2019, 364-days Tbill by 143 bps, 91-days Tbill by 124 bps, and call rate by 90 bps.

The recent measures announced by the FM are more in the nature of addressing pain points of industry

This means that the government bond market reacts well, and those borrowing here tend to gain the most. Here, the biggest beneficiary has been the government, which has a gross borrowing programme of ₹7 lakh crore this year and can lower costs by over 100 bps and save ₹700 crore. Also, the gross Tbill issuance for the year would be above ₹10 lakh crore, getting in a benefit of ₹1,000 crore in interest payments on an annualised basis relative to last year.

How about the corporate bond market? Here, interestingly, the corporate bond spreads over GSecs has moved upwards quite perceptibly. It was by 37 bps for AAA bonds, 71 bps for A rated bonds and 51 bps for BBB rated bonds during this one year period. Clearly, the risk perception on commercial lending has increased and, hence, while GSec rates have moved downwards, the market has priced corporate bonds higher. And, if the market reaction is testimony of the final interest rate, credit has actually been priced higher.

The conclusion is quite revealing. Lowering of rates by RBI definitely helps the government lower the cost of borrowing, which can be up to ₹2,000 crore a year, depending on the tenure of issuance. However, when it comes to commercial credit, banks cannot, and do not, respond the way the central bank would like as they have to also consider the growth in deposits, which is mainstay for them and, hence, transmission will be slow, depending on their requirements. Also, credit risk has to be priced appropriately; and ex poste numbers do reflect the perception. At a broader level, it raises the issue of whether we should at all expect banks to lower their deposit and lending rates when the RBI lowers the repo rate, especially when the market does not support such actions as seen in the bond spreads.

India's stimulus plan short on vision

If Sitharaman and her team can show some strategic thinking around exports, India will be on a roll when global demand eventually steadies and recovers

ANDY MUKHERJEE

Bloomberg



INDIA IS BELATEDLY acknowledging that something's gone wrong with what was once billed as the world's fastest-growing economy. That's the good news. The bad news is that New Delhi still doesn't have a cohesive strategy to reverse the slowdown.

Finance Minister Nirmala Sitharaman did offer a stimulus package on Friday. The highlight was the rollback of a tax surcharge on overseas investors that she herself had imposed in July's budget. It is a welcome concession, though there's no logic in giving global banks a break on derivatives they trade in India while denying the same tax benefit to local hedge funds.

This unfair discrimination against a nascent industry in domestic alternative assets is Exhibit A of the non-strategic thinking that's clouding policy-making in India. Exhibit B is the so-called angel tax on startups, a much-hated levy that has finally been removed. The tax was introduced by the previous Congress Party-led government and treated money raised by fledgling firms as income. Why did this instrument for harassing private businesses stay on the statute books for seven years, when getting rid of it was so simple?

The finance minister's plan to deal with a long and painful slide in the auto industry, where July sales slumped 36%, is Exhibit C. The government will buy more cars for its fleet, she said. That, and an assurance that vehicles purchased now won't become illegal when stricter pollution standards kick in next year, should help deal with some of the inventory buildup. But, carmakers are unlikely to ramp up production until they see a

sustainable return to normal volumes. That will require dealing with both depressed incomes of consumers and a financing funk.

Enter Exhibit D. Sitharaman will hasten the injection of 700 billion rupees (\$9.8 billion) of additional capital into state-run banks, a policy she announced in July. It is not enough. Lenders still need to absorb the full hit from 2.4 trillion rupees of bad debt accumulated in just 16 companies, which they are trying to address outside the courts. Half of that reflects loans to troubled shadow banks,

according to Credit Suisse Group AG. The figures for haircuts being discussed in the media are so large that banks will have little spare capital to expand their balance sheets.

A parallel effort by the Reserve Bank of India to link loan rates to its policy benchmark is a laudable move. Here, though, lenders are bound to look for ways to avoid passing on lower borrowing costs to existing customers. The government isn't willing to face up to the strategic reality that most of its inefficient state-run banks have no strengths beyond their large branch networks, which don't count for much in a digital world.

When you're always fighting fires, it is difficult to turn off the water hose and start tending the garden. The desolate patch that promises the most potential is exports. With the US Pres-

ident, Donald Trump coming very close to pressing the tariff trigger on consumer goods made in China, the country with the biggest claim to insert itself into global supply chains is India, because of the size of its low-paid workforce. Hong Kong-based Li & Fung Ltd, the world's largest supplier of consumer goods, says it is helping one American retailer slash its reliance on the People's Republic to 20% from 70% in two years. Even if Trump doesn't deliver on his ultimate threat, a large opportunity for India has opened up.

The three industries that hold the biggest promise for jobs and suppressed wages are textiles, autos and electronics. The trio can, in turn, support a fourth domestic supply chain—construction and real estate

The three industries that hold the biggest promise for jobs and suppressed wages are textiles, autos and electronics. The trio can, in turn, support a fourth domestic supply chain—construction and real estate. But Bangladesh is ahead in textiles, Thailand is stealing a march in autos, and Vietnam in shining in electronics. If Sitharaman and her team can show some strategic thinking around exports, India will be on a roll when global demand eventually steadies and recovers.

Allowing larger firms to flourish, enabling smaller firms to secure cheap financing and forcing the state to retreat from business would be the great news the private sector has been waiting for. The wait is becoming interminable.

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LETTERS TO THE EDITOR

From denial to acceptance

In spite of the steadily dipping economic trend, the FM presented Budget 2019 in tones of aggressive self-assurance, no different than before. Wiser counsel seems to have prevailed now, for the government realises that it had missed vital sign posts on the way, and is attempting a course correction, with policy rejig, in selective sectors, if only to animate market sentiment. But, Monday morning's market did not jump with joy—it was still cautious. The recent pronouncements of the FM, no doubt, will carry a much delayed feel-good factor. The banks have had sufficient liquidity for quite a while, but officials remained circumspect over lending. The FM, inter-alia, has asked PSBs to lend without fear of inquisition. With ministers, secretaries and lesser officials continuing to face relentless grind for decisions taken while in office, one can only hope that her message would find effective downward transmission. — R Narayanan, Mumbai

PV Sindhu's gold

PV Sindhu has scripted history by becoming the first Indian badminton player to win the World Championship title in singles. This exemplary feat bears a clear testimony to her indomitable spirit and perseverance, with which she overcame all odds and cemented herself as one of the greatest badminton players of the world. Her final match against a formidable opponent, Okuhara of Japan, saw Sindhu display her best en route to her mammoth win. Sindhu's glorious journey from a promising young player to the pinnacle of glory will continue to act as a source of inspiration to all budding players. — M Jeyaram, Sholavandan

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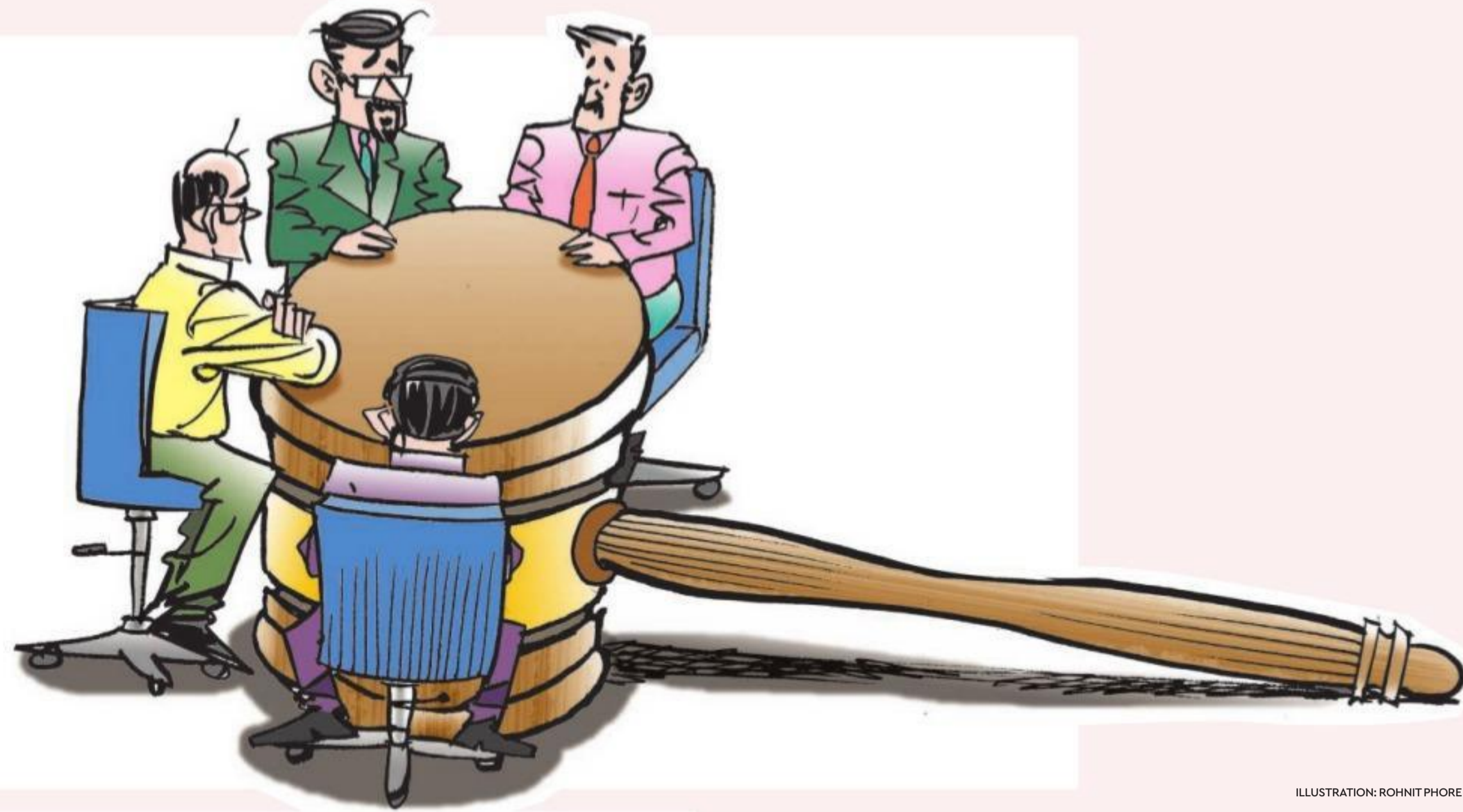


ILLUSTRATION: ROHINIT PHORE

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COMPETITION COMMISSION OF INDIA

Imagining CCI 2.0

While the Competition Law Review report is a comprehensive one, a few issues remain unaddressed. There is no reference to the concept of single-economic-entity, which came up in a few cases prominently in the recent past. Common ownership and its effect on markets remain unaddressed

'Green Channel' for combinations is a long-standing demand within and outside the Commission.

This committee worked on the emerging developments in the digital space and recommended: (i) that provisions may be introduced in the law to identify 'hub and spoke' cartels, and (ii) that agreements that do not fall in the category of horizontal (section 3.3) or vertical (3.4) be coupled in the category of section 3.4 to be evaluated under rule of reason. Besides, the committee has also recommended that transaction based threshold should be applied in the case of combination in the digital space.

Merger of the DG office with the commission with separation of investigative and adjudicatory functions has been recommended. This is not a major change in the sense that the current provisions provide for this, except that the appointment of DG, additional DG, etc, are currently done by the Government, which would simply need to be transferred to the commission.

CCI may be granted a one-time corpus fund. It also may be empowered to charge an ad valorem fee for combination filings. Obviously, this would accrue to the CCI corpus fund. This is a major step in providing autonomy to CCI. However, if a Governing Board were to come about, such autonomy is at risk of being compromised.

Introduction of a bench of NCLAT dedicated to hearing appeals under the Competition Act has been recommended. This is a next-best solution to the reinstatement of the old COMPAT.

The chairperson and whole-time members may sit in panels of three in relation to adjudication, and the composition of the panel may be determined by the chairperson. With only four members now at the maximum, flexibility is limited. The recommendation that there will be no "casting vote" may not be relevant because with three members as quorum, the issue of tie would not arise.

A major recommendation relates to introduction of settlement and commitment mechanisms. This is expected to result in swifter disposal of cases. However, this is confined to section 3(4) and section 4 only. While exclusion in the case of cartels is justified, the exclusion of horizontal agreements other than cartels will take away a number of

future cases from its ambit.

The recommendation to expand the scope of section 19(3) to make the list of factors for determining AAEC in respect of section 3 violations are very relevant and welcome. However, the provision that any other factor may be determined by regulations would render it less useful. Giving discretion to the commission would be a more effective option. In the current law, a similar provision authorising the commission exists in Section 19(4)(m).

The recommendations call for including section 4A that allows for reasonable exercise of IPR as a defence against allegations of abuse of dominance. There is an issue here. Section 4 effectively envisages per se rule. Abuse of dominance is found to be per se anti-competitive. Rule of reason cannot be introduced for IPR without vitiating the architecture of the section.

The recommendation on strengthening of the inter-regulatory consultation mechanism is a step forward, but falls short of the ideal scenario.

While it is a comprehensive report, a few issues remain unaddressed. There is no reference to the concept of single-economic-entity, which came up in a few cases prominently in the recent past. Common ownership and its effect on markets remain unaddressed. The neutrality between public and private sector enterprises has been diluted over the last few years through exceptions to public sector banks in combination process, etc. One expected the committee

to recommend roll back of the same, given the combination regime is proposed to be streamlined and modified substantially. Criminalisation of cartels seems to have been merely looked at by the committee. No arguments in favour of or against the same has been made in the report. It is time to start a discussion on the need for criminalisation of cartels to weed out this cancer. Market studies have been recommended. However, there appears to be no recommendation to seek and obtain information and data for non-enforcement work like this. Provisions exist in mature jurisdictions like the UK. This will enable the commission to initiate *suo motu* cases as also to evaluate the state of competition in major sectors of the economy and suggest policy changes to the government.

There appears to be no recommendation to give statutory powers to CCI to seek and obtain information and data for non-enforcement work

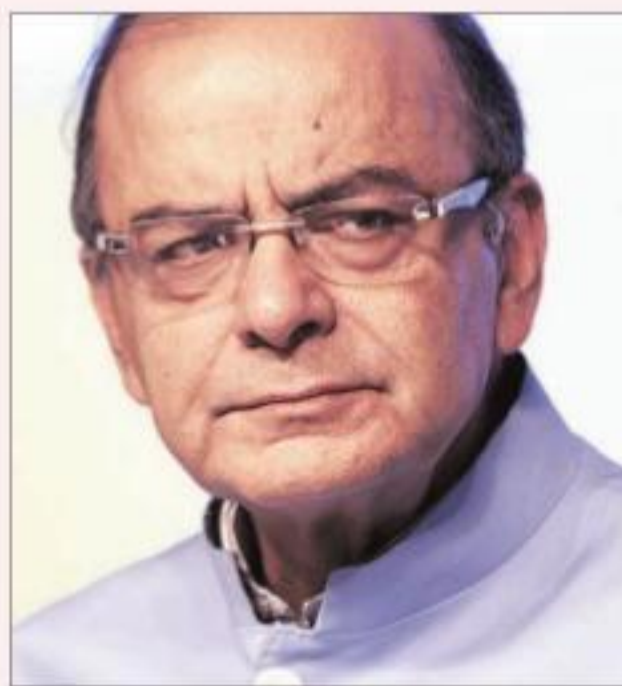
ARUN JAITLEY

India's hero at WTO

As the commerce minister in the Vajpayee govt, Jaitley pulled off some nifty moves that changed the course of trade negotiations at the WTO in favour of developing nations

ABHIJIT DAS

Head, Centre for WTO Studies, IIFT, Views are personal



mutual interest, while marginalising the concerns of India and other developing countries.

The fledgling coalition forged by the diplomats of Brazil and India in Geneva required a formal approval at the political level in New Delhi. Fearing that the price of aligning with Brazil would be to grant market access for its agricultural products into India, some quarters in the Indian government were strongly opposed to the coalition. Jaitley showed immense foresight and astuteness in sensing the value of this coalition. He moved with determination and succeeded in changing the mind of one his influential ministerial colleagues, who was the main person opposing the coalition.

Further, recognising the utility of having China on his side, he openly welcomed that country as a member of this coalition. Eventually, on 20 August 2003, the G20 coalition in agriculture was established. And the rest, as is often recognised at WTO, is history. Henceforth, it would be the developing countries, and not EU-US combine, that would be the most influential voice in agriculture negotiation. Jaitley was one of the principal architects of this tectonic shift at WTO.

Let us now turn to another subject in the Doha mandate, in which Jaitley made seminal contribution—the four new issues: investment, competition, government procurement and trade facilitation. At the insistence of the EU and the US,

and supported by other developed countries, these issues had gate-crashed onto the WTO negotiating agenda. At the Doha Ministerial Conference in 2001, India, along with a few other developing countries, had strongly resisted commencing negotiations on these issues. They saw little merit in overloading the negotiating agenda with new issues that did not hold promise of creating reciprocal benefits for developing countries. In 2003, the mantle fell on Jaitley to prevent negotiations on these issues from moving ahead at the Cancun Meeting. How he achieved this provides many lessons in negotiating strategy and also demonstrates some of his finest personal qualities. In this context, it is worth recalling some episodes at the Cancun Meeting.

First, in one of the small group meetings, Robert Zoellick, the Trade Representative of United States, sought to give a particular twist to the Doha mandate, which would have been adverse to the interest of developing countries. Jaitley's quick thinking saved the day. Using his immense legal skills, he completely turned the tables on Zoellick, who was no mean lawyer himself.

Second, in another incident at Cancun, a marathon meeting, lasting almost 7-8 hours, had just ended at 4 am. Jaitley came out of the meeting room, looking completely exhausted. He was promptly informed that his next meeting would be held within 3 hours. As the meeting was on an issue of immense importance to India, he ignored his tiredness and took a detailed briefing on it for almost 2 hours. His personal comfort took a back seat, when it came to protecting national interest at WTO. Through his actions that day, Jaitley taught all of us young officers the meaning of commitment to the task at hand.

The third incident concerns the coalition of about 100 countries against the new issues created at Cancun. At a crucial juncture, rumours were rife that a key country was planning to abandon the coalition. Jaitley played his masterstroke. He convened a press conference where the minister of this key country was made the centre of attraction. This minister clearly enjoyed the glare of international media and any thought of leaving the coalition was quickly abandoned.

In the face of opposition from more than 100 countries, the Cancun Ministerial Meeting collapsed without taking any substantive decisions. From the discussions, it was clear that at least two out of the four new issues would not remain on the negotiating agenda. And so it proved to be in August 2004. This came about in no small measure due to Jaitley's multi-faceted skills at Cancun.

Immediately after the Cancun meeting collapsed, domestic and international media surrounded Jaitley. His statesmanship emerged in this impromptu media interaction. He resisted the temptation of playing to the gallery and, unlike some of his counterparts from key developing countries, did not take any credit for collapse of the meeting. His measured statement ensured that India would not be singled out as the main country responsible for the collapse of the WTO meeting.

For those of us who had the privilege of interacting with Arun Jaitley at Cancun, his razor-sharp thinking, commitment to duty, strategic approach to negotiations and courage in taking on the developed countries, evident in ample measure at this crucial meeting, shall remain an abiding memory.

May your soul rest in peace, Sir. (While working as a Director in the department of commerce, the author was part of India's official delegation to the Cancun Ministerial Meeting of WTO held in 2003.)

Getting out of the economic coma

KUMARASWAMY

Author of Making growth happen in India



Misaligned monetary policies are at the root of the current rot

EVEN AFTER 28 years of reforms, India is still confused about what market reforms are. There is lack of confidence about their satisfactory working. So, we find a lot of good samaritan interventions, even from 'not answerable to people' regulators who tend to arbitrate between consumers and producers instead of working on making markets more functional. Similar confusion on trying to balance savers' and investors' interest, pensioners' and borrowers', levels of capital account convertibility have led to instability in various monetary metrics. This perhaps is one of the main villains of the current economic logjam. India has near-full capital account convertibility. Quibbles on the definition aside, despite restrictions on tenure, interest rates, security, etc, we are able to raise far more loans than we want in forex. The size of our forex reserve is such that no overseas lender believes that an Indian corporate would default because RBI would fail to provide requisite forex at the time of repayment; default if any would be due to the corporate's own failure. After 4-5 rounds, many overseas banks have developed confidence about regular borrowers. While the country's risk premium has gone down (due to better rating and perception), borrower risk premium is also going down. Although there have been some mammoth overseas transactions by Indian corporates, there is still some distance to cover.

As a result, the dollar interest rates commanded by Indian borrowers is at a much lower level than domestic 'administered' rates and in line with the rates in world markets. Between two open (capital) markets, the interest rates should converge, and where they will settle depends on the relative size and strength. But, to protect pensioners and the poor, we are stubbornly holding up domestic rates, creating problems for investment, capacity utilisation and jobs.

There are various ways to converge the \$ rates and \$ interest rates with differing consequences. One way is to let the domestic rates drift to \$ interest rates. This will cause lesser accretion to our reserves. Both demand and supply will be more equally distant from the pure trade-account-dollar demand and supply, and hence, will be unlikely to disturb the latter. This is what our misaligned policies do not permit. The surplus from capital account keeps the dollar cheaper, making imports more attractive and taxing exports. The second way is to make borrowers hedge their exposures fully. Or impose a tax on interest paid overseas. This will increase the dollar loan costs, converging the domestic rates with \$ interest rates and reduce the surplus dollar supplies from the capital account. But, the purpose of capital account convertibility is to source cheaper capital for the future growth.

The third way may be to impose physical limits on capital dollar and restrict it to imbalance in trade dollar (plus remittances). RBI may be allowed to accrete only 2-3 months of CAD or trade deficit per annum till forex reserves fall back to six-month's import cover from the 10.9 months now. This would mean partial roll-back of convertibility or discretionary action by RBI that is not market-based. The fourth, one-time devaluation, may not help by itself since the capital dollar market does not care for absolute levels as much as its movement during the year, which it translates into interest rates and adds to the interest rates exchanged by the parties. It would help if RBI and the government openly declare that they would depreciate the currency as much as the difference between the domestic rupee interest rates and capital dollar interest rates would warrant on a year-on-year basis. In such a case, the players would price it in and the resultant would be equivalent to the ₹ interest rates. However, this would nullify the beneficial effect of capital account convertibility altogether.

Inconsistent monetary policy, where inflation, exchange rate and domestic interest rates and markets are messed around with, leads to lack of competitiveness and unemployment. Our growth and markets are being gifted to overseas players. There is little else to blame for our misfortune now—aluminium, CAD, reserves, debt/GDP, public investment ratio, are all favourable and should, at better times, be an ideal launch-pad for growth acceleration.

The ideal action for the monetary authorities would be a mix of various alternatives. The trade dollar (without the influence of capital dollar) truly represents the cost competitiveness of the economy. This is what would determine capacity utilisation and employment. As explained here before, capital dollar does not depend on dollar levels. Effort should be made to stabilise \$/₹ rate in the combined market. Capital account should be liberalised on the outbound account as well, so that dollars sitting in reserves and invested in US treasuries earning 1-1.5% can earn a lot more. Tax on dollar interests and limits on reserves accretion would make the exchange rate converge towards trade dollar levels. The government should also reduce the spread over inflation on domestic interest rates. But to lessen the impact on pensioners, it should target interest 'subsidies' by paying them 1-1.5% extra upto a specified extent. This can be financed out of the tax the capital dollar coming in without imports.