The bear will soon visit your garden

Independent directors must look for patterns in reports of disputes and business surprises

THE WISE LEADER

R GOPALAKRISHNAN

Readers of my last three articles in this column (September 13, August 29 and July 5) have asked for an example to illustrate my point that independent directors (IDs) can and should act on signals rather than wait for a crisis to crack open. I had suggested a 5C sequence — consideration of the signals, mutual consultation, counselling, coaching, and confronting.

Public reports of disputes and business surprises distract company managements. They also dilute the confidence of investors, lenders and the ecosystem. Recall what happened with Infosys during the unfortunate sparring of 2016-17, with Ranbaxy when Dinesh Thakur spoke up about fudged Food and Drug Administration data and with MP Birla companies when Harsh Vardhan Lodha sprang his surprise. What can and should an ID do? The developments may appear to be within the law, but what if the consequences stretch the rubber band of minority shareholder interests? The IDs must look for patterns because there always is a pattern to such events. Here is an example, not entirely hypothetical.

Imagine a listed company where there are two promoter-shareholders, A and B. The retail shareholders can be aggregated together as C; assume that A, B and C have about a third a piece. The law requires all directors to act in the company's overall interest, but within this obligation, directors A and B will tend to act in favour of A and B respectively. The C directors are required to act with the interest of the minority shareholder in mind. This is the basis on which they must judge signals.

C directors notice growing and disturbing signals as A and B develop a difference of opinion, strong enough for them to go into litigation. The litigation does not directly involve the company board. What is the duty of the independent directors to protect minority shareholders' interests? It could well appear that the dispute is outside the company and the IDs have little or no role. That is not true. For sure, IDs should avoid taking sides in the dispute, as they would with a neighbour couple who have unresolvable quarrels. Using common sense, I wonder whether IDs can consider a three-step action plan.

■ IDs could, singly or severally, try to persuade the directors representing the disputants to step off the board while they sort out their difference through dialogue, arbitration or litigation. This may help to sequestrate the company from media reports. A and B nominated directors could return to the board after sorting out differences. C directors have no legal right to seek this action or to enforce this, but they can surely make a request. Their request may well be ignored or rejected.

■ As a next step, IDs could write to regulatory or empowered agencies about their apprehension of a decline in share prices; since A and B directors are on the board, would their agency like to intervene? The regulator or agency may ignore or reject this request.

■ As a final step, the IDs could resign from the board, singly or severally. They should not quote the lame duck excuse that they have many priorities, rather they should state their apprehension with transparency, as the law demands. A and B would surely not like it and may even feel pressured to avert such an outcome.

Borrowing from Harvard Professor Eugene Soltes' *Why They Do It: Inside the Mind of the White-Collar Criminal*, IDs who are silent might regard the situation as a business problem, but their actions can be deemed as moral failure. It appears that the IDs did not act in minority shareholders' interests in ICICI Bank and Jet Airways. On the other hand, IDs in CG Power responded by removing the chairman. If IDs adopt an appropriate and calibrated approach, they can develop a moral response as the ominous signals develop. Think of IL&FS, Yes Bank and HDIL/PMC.

A non-corporate practice is of the government booking profits by selling its PSU shareholding to another PSU. The government reports the gain as revenue in its budget accounts. Recall LIC buying IDBI shares or BPCL shares being bought by ONGC. Such practices may be permissible, but are morally questionable.

When I used to visit Bulgaria in the 1980s, I would often hear an expression about bears. I learnt what it meant — if the bear dances in your neighbour's garden, it will soon be dancing in yours for sure.

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CHINESE WHISPERS

No country for old men

Turmoil in the Uttar Pradesh unit of the Congress is showing no signs of abating. Some senior leaders seem unhappy with the manner in which the UP Congress Committee (UPCC) was reconstituted and the way General Secretary Priyanka Gandhi Vadra (*pictured*) is asserting her authority in the choice of key office-bearers. Peeved at being cold-shouldered, a senior Congressman and the party's prominent Muslim face in UP, Siraj Mehdi, has resigned from the party and has sent an emotional letter to party President Sonia Gandhi. He lamented that the new UPCC gave no representation to the Shia community while the Bharatiya Janata Party governments at the Centre and in UP had nominated Shias in key positions. Mehdi also alleged there was no place for 50-plus leaders in the Congress.

Rahul breaks out of his shell

Contrary to initial reports that he would not, Congress leader Rahul Gandhi will campaign for his party in Haryana and Maharashtra. Gandhi quit as the party chief after the Congress' debacle in the Lok Sabha polls and had implored senior leaders to follow his lead. None of the veterans have heeded his call, while several of the younger ones have either been sacked or quit their positions in the party. Gandhi's team has refused most requests by party candidates to campaign for them, and acceded to a handful where the candidate is not part of the party's old guard. Gandhi, who returned from his foreign sojourn, appeared before a court in Surat in a defamation case on Thursday. He will address his first public rally in Dharavi on Sunday where Varsha Gaikwad, daughter of Mumbai Congress chief Eknath Gaikwad, is seeking re-election. During Rahul Gandhi's tenure as party chief, Varsha was AICC secretary for Gujarat and Madhya Pradesh Assembly polls. Gandhi will also address a rally in Latur where former chief minister late Vilasrao Deshmukh's sons Amit and Dheeraj are contesting. He will campaign in Haryana on October 14, and return to Maharashtra for another round of campaigning on October 15.

High Commissioner for a day

Ayesha Khan, a 22-year-old from Gorakhpur, Uttar Pradesh, won the "High Commissioner for a Day" competition and the chance to be the UK's top diplomat to India. The British High Commission said on Thursday Khan spent October 4 overseeing the UK's network in India, chairing briefing sessions, networking with dignitaries, and meeting project beneficiaries. Now in its third year, the competition is a celebration of the "International Day of the Girl Child" (October 11) and was open to Indian women in the age-group 18–23. As part of the selection process, applicants were asked to record a one-minute video on why gender equality was important and state who their biggest gender-equality inspiration was.

China's rise and its challenges

For a political dispensation that has long relied on providing high economic growth rates to sustain political legitimacy, the current slowdown is a huge problem

HARSH V PANT

China celebrated 70 years of Communist party rule this week with great pomp and circumstance, showcasing its growing prowess with the military parade of troops and weapons including new hypersonic drones and intercontinental ballistic missiles. According to China's Ministry of National Defence, 15,000 military personnel along with 580 pieces of military equipment and 160 aircraft participated in the parade. Chinese President Xi Jinping who is now almost as powerful and influential as Mao marked the occasion with a speech which was as much directed to the domestic as it was to the global audience. From the same spot where Mao had announced the establishment of the People's Republic of China on October 1, 1949, Xi asserted that "there is no force that can shake the status of this great nation. No force can stop the Chinese people and the Chinese nation forging ahead".

Mao's legacy remains contentious as tens of millions of people died during his catastrophic Great Leap Forward, and the country was plunged into violent chaos during the decade-long Cultural Revolution. It was after his death in 1976 that Deng Xiaoping pursued economic reforms resulting in the dramatic rise of China to its present day status of a global economic superpower. The last four decades have seen China launch serious market reforms, thereby opening up its economy to the wider world and lifting hundreds of millions of people out of poverty. It is a remarkable story of a nation's rise amidst major challenges, of a country emerging from being one of the poorest to one virtually setting the global economic agenda today. Beijing is today focused on the next phase of its global economic evolution by presenting to the world an ambitious vision of global infrastructure and connectivity — the Belt and Road Initiative. It remains very controversial and is facing a number of challenges but there is no denying the fact that it has transformed global conversation on connectivity, forcing major global powers to present their own versions as alternatives.

As Xi Jinping has consolidated power over the last few years, he has repeatedly underlined the need to resurrect the "Chinese dream" — of a nation that remains keen to return to its former glory. Under Xi, China's old reticence of acknowledging its rise is gone and a new assertion of its global standing is quite evident. For the Chinese Communist Party, it is imperative that its own centrality in the evolution of China as a prosperous and powerful country is underscored. That, after all, is the raison d'être of its existence. And so far it has been quite successful in managing the nation's affairs, having now outlived the Soviet Union.

A float featuring China's national emblem travels past Tiananmen Gate during the parade celebrating 70 years of Communist party rule in Beijing REUTERS

The CCP would be hoping that the 70th anniversary celebrations would further consolidate its hold, enhancing its legitimacy and generating popular support at a time when a range of challenges have emerged to confront China, both economically and politically. The Trump administration has overturned decades of political consensus in Washington about integrating China in the global order. It is now openly confronting China at multiple levels. Most significant of the problems is in trade where the tariff war between the two most powerful economic powers has escalated. China's economy has been hurt and its growth rate has fallen. For a political dispensation that has long relied on providing high economic growth rates to sustain political legitimacy, this is a huge problem.

Strategically, China is now facing a stronger pushback in the wider Indo-Pacific where regional powers are arranging themselves in new coalitions to challenge China's aggressive projection of its power. Like-minded countries see a need for a new security architecture in the region which can manage China's rise. While a formal system will take time to emerge, informal coalitions are now growing in number and issue-based coalitions are the norm. It is clear that China's assertiveness will not go unchallenged.

Perhaps most significantly for China it is the problems in what it considers to be its core interests that are becoming difficult to handle. Beijing's handling of its Uighur minority in Xinjiang region is now being widely criticised. In Taiwan, there is growing distrust about Beijing's motivation and anti-Beijing political leadership is gaining in support. And in Hong Kong, China is facing a crisis unlike any it has faced since the 1989 Tiananmen massacre.

In his speech, Xi promised to "maintain the long-term prosperity and stability" of Hong Kong and to uphold the political framework of "One Country, Two Systems" which gives the city limited autonomy. If anything, it should have been clear to Beijing by now that the model proposed by him is actually no longer working in Hong Kong. Anti government protests that started off targeting the controversial extradition bill have morphed into something much bigger. And that anger will now continue to shape Hong Kong's future engagement with Beijing. Even as China was celebrating this week, protests in Hong King took a turn for the worse when a teenager was shot dead by the police.

So as China celebrates a major milestone in its political evolution, its political leadership is facing a domestic and global landscape that has altered significantly in the last few years. How deftly these challenges are managed will determine the future trajectory of China's rise.

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INSIGHT

When is a good time for austerity?

DHIRAJ NAYYAR

In general, austerity is a good trait in governments, just as thrift is a virtue for entrepreneurs, just as there is wisdom in frugality for households and individuals. Perhaps, those are the foundations of any high savings, high investment and highly productive economy. But all economies go through cycles. How governments, companies and households behave in the different phases of the cycle matters. They could either exacerbate the booms and busts or smoothen the cycles at both ends.

It is apparent that the Indian economy has a demand problem. Three of the four major engines of the economy are stalling, certainly not revving up -- private consumption, investment demand and exports. The government has its hands on the levers of the fourth engine -- its own spending. It is hesitant to put it on full thrust primarily because it has a fiscal deficit target to meet or a fiscal deficit glide path to adhere to. The move to cut corporate taxes was bold. But given the mess in the banking and non-banking financial companies space, investment is not likely to revive immediately. There is scope for taking a bold step forward on personal income taxes. That would give an immediate boost to consumption.

At the same time, the government must not cut its spending, particularly on infrastructure. It would be a good idea to mop up revenue through disinvestment to bridge some of the deficit but it is time to abandon the fiscal glide path to the target of 3 per cent of GDP. If there is one lesson that has been learnt from the experience of countless countries around the world over the last three decades, it is that austerity is the wrong medicine to administer when growth is low. It only makes recovery more difficult and extracts a high cost from the most vulnerable people in the economy.

There is a time for austerity — when there is a boom. Governments should aim for a minimal deficit or even surplus in a period of fast growth so that there is cushion when the downturn arrives. Unfortunately, the abundance of boom time incentivises precisely the opposite spending behaviour from governments. Redistributive spending of the unproductive kind usually peaks at that time, not just in India but elsewhere in the world as well.

It is because of this errant behaviour of governments that austerity has become part of the economic policy orthodoxy over the years. If the reason for a serious downturn in the economy is runaway government spending in periods of high growth (the story of India in the 1980s running up to the crisis of 1990-91) then the antidote ought to be a tight curb in government expenditure. However, it is not runaway government expenditure alone but runaway government expenditure coupled with a supply-constrained, unreformed economy that leads to a collapse in growth. In 1991, India undertook structural reforms which is why the negative effects of austerity were not felt for long. Fortunately, in 2019, there is no crisis. However, to revive the trajectory of growth, it is important for structural reforms to continue while the government runs a counter-cyclical fiscal policy.

Interestingly enough, companies and even households mirror government spending. Companies usually acquire flab and over extend/over-leverage themselves in periods of high growth and then tighten their belts only when the downturn comes. In the process, they add a multiplier to the boom on the upside but also a negative multiplier on the downside. For households in India, at least until a decade ago, savings tended to be high irrespective of the business cycle. In a more consumption-driven economy, that rate has come down. If indeed households too are overspending in good times and cutting back sharply in bad times, they too may be aiding in exaggerating both ends of the cycle.

The economy would benefit if governments, companies and households acted counter-cyclically. Right now, in India, they are all acting cyclically which is why the economy is slowing down further instead of picking up. It is important for someone to break the cycle. In the short term, only the government can do so with a strongly counter-cyclical fiscal and monetary policy. Once growth begins to climb back, companies and households will likely loosen their purse strings.

By global standards, India is hardly an overspending, deep-in-debt economy. In fact, the debt-to-GDP ratios of households and companies is considerably lower than in most advanced economies and even China (which has switched from an export-oriented model to a leveraged-growth model in recent years). There is plenty of room to finance animal spirits. But first, the downturn must be arrested. And then, once growth has recovered, the government can return to a path of austerity as companies and households take over the task of driving the economy.

The author is chief economist, Vedanta

LETTERS

Overlook the side effects

This refers to "A new fix for economic decision-making" by A K Bhattacharya (October 9). The issue was waiting to be raised since quality of decision-making lies at the root of effective governance. The process essentially involves defining a problem, generating alternative courses of action and assessing probable outcomes in the face of ground reality. In actual practice, the process gets vitiated. Decisions are made at the highest political level in the government based on predetermined perceptions of problems. This is followed by preparation of necessary paperwork providing justification for the decision made, which is then put up for formal approval. The involvement of experts in the field remains a superficial formality. The likely side effects of proposed solutions are overlooked.

Once a decision is implemented, its success or failure has to be judged by results, not the original intention. The same yardstick applies to political decision-making as well. The impact of decisions on Article 370 and the National Register of Citizens will show up in the direction of events in the next few months. The country must reap the benefits that come from a decisive government. However, one is tempted to say that a secure and confident political leadership need not feel shy of looking at sincere dissenting views before finalising decisions. The main objective of governance is not to outsmart the Opposition.

Political decision-making and economic policies of the government may not be entirely independent of each other. Apart from garnering votes, political decisions do impact a nation's social fabric which in turn affects the investment climate and inflow of foreign direct investment. The government needs to ensure that its political and economic policy making are not antithetical to each other.

Vinay Kant Kapur New Delhi

Don't let Kerala Bank fail

Since the beginning of the last century when the cooperative movement emerged in India, cooperative banks have played a proactive role in the economic development and social life of Kerala. Attempts by vested interests to capture and manage cooperative institutions and efforts to circumvent regulatory and supervisory requirements did affect the growth of this ideal institutional system, off and on. The problems faced by cooperative banks during demonetisation (2016) and the recent failure of the Punjab and Maharashtra Co-operative (PMC) Bank can be traced to such intervention by external forces.

The conditions relating to capital adequacy, management and institutional set-up subject to which the Reserve bank has given the go ahead to Kerala Bank appear very liberal. In the context of the recent PMC Bank failure, the stipulation that administration and management will be guided by the present guidelines for managing urban cooperative banks may need review even before the commencement of business by Kerala Bank.

In all probability, it will be the biggest cooperative bank in India and soon get categorised under the "too big to fail" category. That adds to the central government's and the RBI's responsibility to ensure that the dual control (state government having a major role in management matters and RBI's regulatory and supervisory role) does not adversely affect the institution's smooth functioning.

M G Warrier Mumbai

Lack of accountability

All the bigwigs of the dubious PMC Bank are in custody. This does not assure us that the victims will get their money back. Soon the scamsters will get bail and flee the country. Why are the auditors not being taken to task? Surely, such a huge fraud could not have escaped their eyes. Further shouldn't also the income tax authorities have noted their ultra lavish lifestyle? There is yet another case of total lack of accountability. An example of closing the stable door after the horse has bolted.

Shanmugam M Pune

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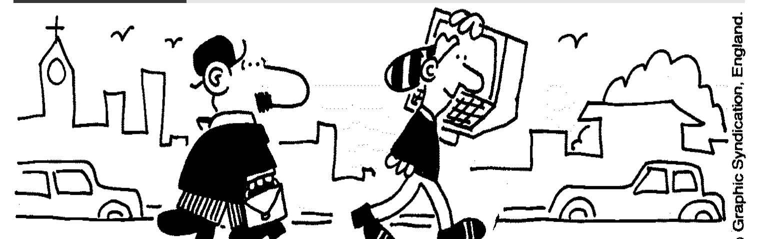
HAMBONE



Business Standard
Volume XXIV Number 42
MUMBAI | FRIDAY, 11 OCTOBER 2019

Need for a structural push

A 10-notch slip in India's competitiveness calls for wider reforms

The global economy is slowing in a synchronised way and, according to the International Monetary Fund, as much as 90 per cent of the world is expected to witness lower growth this year. The Indian economy has also slowed sharply in recent quarters with growth slipping to a six-year low of 5 per cent in the April-June period of the current fiscal year. Recovery is not expected to be swift at a time when the global economy is losing steam. That would require significant policy intervention. The need for deeper policy intervention in India is also underlined by the latest global competitiveness index of the World Economic Forum (WEF).

In the competitiveness rankings, India slipped 10 notches to 68th position among 141 countries. China was 28th, while Singapore replaced the US at the top slot. Although India's overall score declined only marginally in absolute terms, improvement by other countries pushed India's ranking down. This underscores an extremely important point that an economy like India needs to keep improving its competitiveness to maintain its position. Capital flows are extremely mobile in today's world and tend to move to markets where they are likely to get the best risk-adjusted returns.

The WEF rankings are based on 103 individual indicators, which have been put under 12 "pillars", such as institutions, macroeconomic stability, market size, and innovation capability. India managed to secure a place in the top 50 in just four categories. However, there are risks in these indicators too. For instance, India ranks better in macroeconomic stability and the depth of the financial sector. Stress in government finances and renewed risks in the financial system could affect India's growth prospects and competitiveness in the near to medium term. Although India has gained in the adoption of information and communication technology, it still has a fair distance to cover. India ranks poorly in product market efficiency, largely because of a lack of trade openness. The government has increased tariffs in recent years, which will affect India's competitiveness. Further, India slipped from 75th to 103rd position in labour market competitiveness. The government is in the process of reforming labour laws, but other countries are moving at a much faster pace. It is important to note that in a globalised economy, where countries are competing for markets and capital, changes on the margin may not help. Slow and inadequate reforms in the labour market, among other things, will not allow India to attract firms looking to relocate from China. Besides, India is lagging behind in health and skill development.

The need for deeper structural reforms, both in governance systems and markets, cannot be overstated in India. The fall in India's ranking not only highlights the need for reforms but also underscores their urgency. India needs to move faster than its peers to improve its attractiveness as an investment destination. Although structural reforms may not immediately push economic growth, they will help increase potential growth in the medium term. What can work in India's favour at the moment is that it has a strong and stable government, which is not averse to taking swift decisions. A sharp reduction in the rate of corporation tax last month is a case in point. However, it remains to be seen whether the government intends to back it up with wider reforms.

The pharma challenge

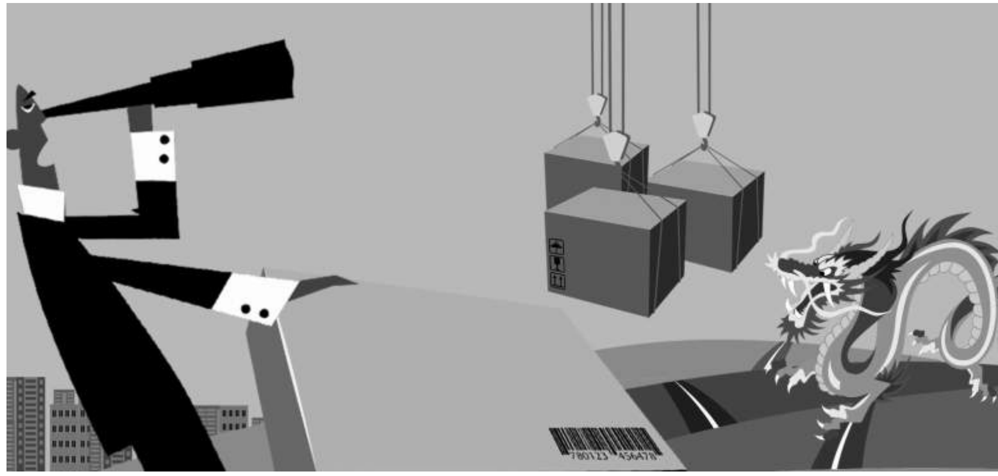
India must act urgently on counterfeit drugs

In August, the deputy drug controller at the Central Drugs Standard Control Organisation (CDSCO) in New Delhi was taken into custody by the Central Bureau of Investigation, reportedly for corrupt practices related to drug approvals. Several other such arrests have been made at the regulator associated with the Union government as well as some state governments. The regulator itself has recognised in the past year or so that there are aspects of its functioning that need to be altered, which is partly why it undertook a massive reorganisation and mass transfer of officers earlier this year. Advocates of consumer protection are nevertheless convinced that drug administration in India is flawed and lets too many counterfeit drugs through; smaller drug makers are convinced, contrarily, that the regulators are too likely to claim their products are substandard, in order to maintain the advantage of larger generics producers.

The effect of the chaos in India's drug administration is that nobody is quite certain how reliable medicines sold in the market are. Some official figures claim that counterfeit — which includes substandard — drugs in India are less than 2 per cent of those in stores. This is perhaps difficult to believe. In comparable markets such as many African countries, about a third of drugs have been found to be counterfeit. And, indeed, an overwhelming majority of those counterfeit drugs are imported from India. Unsurprisingly, independent studies such as those by the World Health Organization have shown much higher numbers. But such studies have been dismissed by domestic authorities. Under such circumstances, one of the first and most important steps must be a clearer sense of the actual position in terms of counterfeit and substandard drugs. It is easy to see why there is no clarity in this respect — neither the existing regulator nor the drugs companies would be served by a more general understanding of how they are both under-performing in their mandates. However, a broad, transparent and well publicised survey would not just be important on its own merits, but also be extremely useful in terms of mobilising public and political energy for a broader reform of the pharmaceutical supply chain.

That such political energy and investment are overdue is unquestionable. Consider the consequences of one sort of counterfeiting — the production of drugs that, while correctly labelled, have too little of the active ingredient. When such drugs are antibiotics, the public health consequences in terms of the mutation of micro-organisms are severe. This is another reason why India is a superbug hotspot — antibiotics are prescribed too often, and they are sometimes substandard. The next step must be to isolate each step in the supply chain of drugs, and ensure that sufficient regulatory capacity has been created and assigned to each of these steps. It is also necessary to ask whether the state and central drug controllers are duplicating their capacity and efforts, and whether an overall reorganisation and harmonisation are necessary. In the end, the crucial additional requirement will be investment in regulatory capacity, and clear accountability on the part of the regulators. Too often, problematic individuals shift to the regulator and then back to the line health ministries to protect themselves from accountability. This practice must end. The pharmaceutical regulator must be properly resourced — and staffed independently of the health ministries.

ILLUSTRATION: BINAY SINHA



A half-trillion dollar shift away from China

There is an opportunity for countries to grab exports worth $450 billion that India cannot afford to miss

TESSELLATUM
NEELKANTH MISHRA

These days rarely a day passes without trade wars making the headlines. And yet, despite more than a year of duties on US merchandise imports from China, and a synchronised global slowdown nearly universally blamed on the trade wars, the headline trade numbers do not seem to have changed much. To investigate this, Credit Suisse surveyed a hundred global companies (with a combined $1 trillion in annual sales), and pored over trade statistics as well as longer-term economic trends.

Beyond the obvious policy uncertainty (negotiations are still ongoing), we found two main reasons why there has not yet been a more aggressive shift of manufacturing away from China. First, capacity in China is not merely for exporting to the US, but also for the growing domestic demand, as well as for other non-tariff affected export markets. Over the past year or so, a decline in China's exports to the US has been offset by rising exports to the European Union (EU), Vietnam and other nations. While some of this could just be products being re-routed to avoid the duties, a significant part, in our view, was Chinese manufacturers redirecting their surplus capacities to other markets.

And this brings us to the second reason. More than three-fourths of the Chinese exports to the US — that are finished goods sold directly to consumers, such as apparel, toys or handsets — are coming under duties only in the final list. The first three lists mainly had intermediate goods or those sold to corporations, where the duties did not cause a large and visible price impact on end-consumers. The finished goods sold in the retail market that were part of these earlier lists, such as washing machines, saw significant price increases post tariffs, and that drove down demand. Given that manufacturers use Chinese capacity for global demand, their first response to tariffs in only one country would be to raise prices in that geography. It is only when demand volumes get affected that the pressure to shift capacity would rise, and that should pick up now.

But this only seems to be accelerating a medium-term trend already in play: Nearly two-thirds of firms we surveyed were either already moving some of the production out of China, or were planning to. More than 90 per cent of these would do so even if the tariffs imposed by the US government were reversed.

The main reason is the shrinking Chinese workforce, which is estimated to fall by a further 50 million by 2030. One would assume that this decline would come mainly from the 200 million Chinese workers still in agriculture, but interestingly, the manufacturing workforce has dropped by almost 20 million in the last four years, making both labour cost and availability a challenge for manufacturers. We estimate that number could fall by a further 9 to 15 million in the next five years in the labour-intensive sectors of electronics and appliance assembly, apparel and textiles, footwear, toys and furniture.

The impact on Chinese exports would be exacerbated by growing domestic demand in China. China's rising dependency ratio (that is, the number of individuals dependent on a worker: Children or retired people) bottomed out a decade ago, and has been rising ever since, a natural consequence of the one-child policy implemented four decades ago. As the number of consumers and their ability to consume grows, but the number of producers falls, its surplus production available for exports is likely to fall faster. While mechanisation may help grow production at the margin, robots today are nowhere close to providing the range of actions that humans have, particularly at current costs.

We estimate that $350-550 billion of exports could switch out of China in these industries in the next five years: The number could be much higher if the other countries are able to absorb it. Vietnam, for example, which topped the list of countries that companies in our survey said they were moving manufacturing to (India was second), is too small given the scale of the opportunity: It grows manufacturing GDP by just $5 billion every year and firms feared it "would fill up in five years". Bangladesh gets almost 90 per cent of its exports in apparel, and languishes on nearly all metrics of "ease of doing business". Other East Asian nations are either not large enough or lack the labour cost advantage: They may benefit from manufacturing shifts in high-technology goods.

A large part of the increase in the global workforce till 2030 is likely to happen in sub-Saharan Africa, India, Pakistan, Indonesia, North Africa, and West Asia. With the exception of India and Indonesia, most of these have struggled to grow labour productivity meaningfully and sustainably, implying they are not natural options for firms exiting China.

Unfortunately, India too is punching well below its weight. Several large technology firms are indeed investing in India as an export base, and 25 per cent annual growth in electronics manufacturing in India over the last four years has managed to stall the increase in net imports of electronics. Self-sufficiency has improved not just in handsets but in consumer appliances too (like air-conditioners). Much of this is merely assembly so far, but the component supply chain is also starting to move to India.

But India is not even on the radar for high-technology manufacturing shifts, and the most disappointing and perplexing trends are in apparel, where wage costs make a big difference. This despite there being a local ecosystem and most large buyers already having sourcing offices in the country. Cotton apparel exports shifting out of China have moved to Bangladesh, and synthetic apparel to Vietnam. There is at least a reasonable explanation for cotton, given that wages in Bangladesh are half that of India, in addition to more flexible labour laws. In synthetic apparel, however, despite workers in China being nearly three times more expensive than in India, and even Vietnam now 30 per cent more expensive, India has barely any export share. Business owners say that high import duties on chemicals that are used to make synthetic yarn have stunted the whole value-chain in India.

Foreign direct investment was rising even before the recent cut in corporate tax rates: One of the few bright spots in the Indian economy in the past six months. It should continue to be strong, but the opportunity is much larger, and one that is only India's to lose.

The writer is co-head of Asia Pacific Strategy for Credit Suisse

Fiscal policy and the growth slowdown

RATHIN ROY

Several economists have recently argued for increasing public expenditure, through deficit financing, to address the current growth slowdown. This argument rests on the premise that increased government spending would enhance purchasing power in the hands of consumers and firms and, thereby, increase aggregate demand to bolster growth.

I want to unpack the analytics of this argument. For those who consider the current slowdown to be "cyclical" (I don't), this is an obvious textbook prescription — spend more during downturns, less during upturns.

This argument is misplaced. First, public spending has, in fact, been expansionary over the past few years. While on-budget fiscal expansion at the Centre is limited by the perceived need to keep the reported fiscal deficit/GDP ratio under control, off-budget borrowings have easily crossed 1 per cent of GDP, even by my conservative estimates that are much lower than those reported by the Comptroller and Auditor General of India. Second, some commentators repeatedly, and wrongly, assert that the 3 per cent fiscal deficit target is arbitrary; they seem ignorant of the reasoning embedded in every report of the Finance Commission and fiscal responsibility and budget management since 2003, that with financial savings at around 10 per cent of GDP, the public sector borrowing requirement is no less than 7.5 per cent of GDP, even discounting off-budget borrowings. Further increases in public sector debt would only add to the high cost of capital that is sought to be lowered on the monetary and credit policy side. Gains on the fiscal swings mean losses on the monetary roundabouts. Glib allusions to "counter-cyclical" policies without considering these realities is irresponsible.

Fiscal expansion on purportedly Keynesian grounds can be secured through the balanced budget multiplier. When growth is demand constrained, government taxes private income and increases its own consumption or investment expenditure to boost aggregate demand. Thus, increased taxes finance increased public spending, with a net positive impact on aggregate demand. This does not work if taxes are not elastic or if the fiscal machinery is demonstrably unable to increase the tax-to- GDP ratio at will. So, the implicit assumption (justified in the Indian context) is that this is not possible; the second best solution must be adopted — government must borrow more. I wish new-born Keynesians would make this explicit.

The question then is: On what should government spend this extra borrowing? India has long been in a situation where over two-thirds of central government borrowing is for revenue expenditure. Borrowing for public investment sounds like a good idea but the fact is that a lot of public investment (like defence), involves spending on imports; a further chunk has been deployed for financial investment, not fixed capital formation. Fixed capital formation at the central level is too small, and the time lags in executing such investment too long to make a difference, even if the magnitude is temporarily doubled.

Government can borrow to increase revenue expenditure on transfers. This would alleviate the problem as long as the macroeconomic assumption is that there is capacity underutilisation across the economy. But I have been pointing out for some time now that the Indian economy faces a structural demand problem driven, *inter alia*, by the lack of wider participation in economic activity, limiting effective aggregate demand, even as growth slows in extant sources of demand for things measured by the "leading indicators" (automobiles, FMCG, consumer durables) of the economy. Add to this the problems faced by the financial sector, poor transmission of credit policy, and a public sector and public administration that is, collectively, a deadweight drag on productivity (with a few honourable exceptions) due to years of neglect of necessary administrative and structural reforms.

In these circumstances, transfers will, at best, facilitate a temporary increase in aggregate demand in sectors other than the leading indicators. The supply response to this will persist only if such transfers financed by borrowing are maintained over the medium term. This is because the aggregate demand increase is powered only by transfers, not increases in income. Since the problem is structural, it will not go away, simply by boosting generic aggregate demand through transfers. Hence, permanently increasing government borrowing to pay for transfers would only reinforce the structural demand problem.

And should I even bother pointing out the negative consequences of such persistent fiscal imprudence, and the historic price India has had to pay for this, across our history? The addiction to deficit financing seems to afflict so many policy commentators, with the result that (as former CEA Shankar Acharya wrote in, "Fiscal deficits — a short history", March 8, 2017, *Business Standard*) the historic record of central government on deficit financing resembles that of an alcoholic struggling to keep addiction at bay.

Of course, an asset rich, but revenue poor, central government could monetise and deploy assets to boost aggregate demand by pursuing laudable structural policies like doubling farmers' income and scaled up investments in renewable energy and affordable housing. This government has shown willingness and fiscal appetite for such initiatives, but not, yet, the political will to address the binding constraint —the regulatory and institutional legacy hurdles that inhibit the speedy execution of these initiatives. Event management can distract from, but not permanently mask, execution failures. Addressing these hurdles that do not cost money should be the central focus of economic policies when faced with a structural slowdown that has deep domestic roots.

The writer is director, National Institute of Public Finance and Policy. Views are personal

Kashmir's partial story

BOOK REVIEW
CHINTAN GIRISH MODI

It is simplistic to frame the communications blockade in Kashmir as a battle between Hinduism and Islam, or even Hindutva and Islamism. India does have a majoritarian government with little respect for democratic institutions, and it ought to be held accountable for human rights violations. However, the erstwhile state of Jammu & Kashmir has a beleaguered history that extends far beyond the present dispensation in Delhi. The reorganisation of this state into two Union Territories — Jammu & Kashmir and Ladakh — must be understood in relation to what has transpired in this region in the past, and India's aspirations to counter Pakistan and China on a political chessboard where these two play as one team.

Iqbal Chand Malhotra and Maroof Raza's book *Kashmir's Untold Story: Declassified* will hold the interest of readers who are married to the idea that Kashmir is an integral part of India, and that India should do everything it possibly can to defend this claim. Mr Malhotra has studied economics, and worked as a television producer. His grandfather apparently used to spend Sunday afternoons with Maharaja Hari Singh at Bombay's Royal Western India Turf Club. Mr Raza is a commentator on military and security issues. He used to serve in the Indian Army, and now works as a consulting editor with a news channel on television. What began as a collaboration between them on a documentary film eventually became a joint book project.

Kashmir's Untold Story: Declassified is a page-turner high on political intrigue but so densely packed with detail that it can be disorienting for readers who are encountering this information for the first time. The chapter titles give the impression that the authors view Kashmir as a crucible of conflict, and not as the home of people who have lived there for centuries. These titles are: 'Unfathomable Depths', 'Cloudy Waters', 'Emerging Ripples', 'Swelling Crests', 'Lashing Waves', 'Temperamental Tides', 'Stormy Seas', 'Emerging Abyss', 'Deeper Waters, 'Rising Tsunami'. Messrs Malhotra and Raza are interested in questions of security and strategy from the perspective of a nation-state that would like to contain and neutralise all threats to its sovereignty. They do not engage with the sentiments of Kashmiris affected by the ongoing conflict, the impact of militarisation on their mental health, their aspirations for self-determination, or their unflinching resistance.

Since the book does not present itself as a people's history, the authors think that they can get away with downplaying the mass rape of Kashmiri women in Kunan Poshpora in 1991, and the use of pellet guns on unarmed civilians during the wave of protests that followed the killing of Hizbul Mujahideen commander Burhan Wani in 2017. These events have been widely reported but this book, in its refusal to acknowledge what has happened clearly betrays its ideological sympathies. It is uncritical of the Armed Forces Special Powers Act, and stays away from addressing the issue of disappeared persons, encounter killings and mass graves —all of which are part of the Kashmir story. It makes no effort to show how ordinary Kashmiris who wish to lead a peaceful life have become disposable citizens while their land continues to be valued for its strategic importance.

Messrs Malhotra and Raza have undertaken an exhaustive analysis of why the erstwhile state of Jammu & Kashmir has been significant for the British, the Americans, the Russians, and the Chinese at various points of time, and what this has meant for the relationship between India and Pakistan. This conflict might seem bilateral on the surface but it has multiple stakeholders. There are no permanent allies or enemies in the world of politics. Equations change when interests align in mutually beneficial ways. This book will help readers appreciate why Prime Minister Narendra Modi and Prime Minister Imran Khan are pursuing diplomatic channels to gather support from various countries. The Cold War of yore might be over but the international community is still divided into camps. India and Pakistan need to know who will have their back when the time comes.

The authors also expose how Pakistan has sought to weaponise Islam in Kashmir by promoting a puritanical version of the faith through Wahhabi madrasas sustained using illegal funds transferred across the Line of Control. This assault on Kashmir's syncretic culture and Sufi traditions from Pakistan-backed Islamist outfits has conflated *azadi* with *jihad*, and has given a religious subtext to an indigenous freedom movement. It is evident that Pakistan's interest in Kashmir, just like India's, is tied to its natural resources and strategic location. If Pakistan cared about Muslims, it would not overlook Chinese atrocities against Uighur Muslims, or wage a war against its own Pashtun and Baloch citizens. What it cares about is Chinese money.

KASHMIR'S UNTOLD STORY: Declassified
Iqbal Chand Malhotra and Maroof Raza
Bloomsbury, 202 pages, ₹499