Trends in the new year

Just about a month old and 2020 is turning out to be an interesting, even momentous, year for businesses in India

ACROSS THE BOARD

SHAILESH DOBHAL

Republic Day is behind us, and the Union Budget, with expectations running high for it to deliver the economy out of the morass, is a few days away. Just four weeks into New Year 2020, and it is already looking like an eventful, nay momentous one, as far as world of business is concerned. Here are five reasons for it.

Global goliaths can be gobbled up in India: Indian business history is replete with examples of global behemoths trampling or gobbling local competitors. Think soft drinks (Coca-Cola buying Parle's five leading soft drinks brands), electronics (the Japanese and Koreans virtually pushing Indian brands out of the market), cars (Tata Motors waging a lonely battle against the might of Japanese and Korean carmakers) or consumer expendables (Anglo-Dutch Unilever's Indian subsidiary buying Tata's fast moving consumer goods business in Lakme, Tata Oil Mills). You get the drift.

Though it is being billed as the making of a duopoly after the third-ranked player was acquired by the second ranked, perhaps in a rare instance, homegrown firm Zomato bought American Uber's Indian food delivery business, Uber Eats, in an all-stock deal last week. Though not in the same league as Didi Chuxing buying Uber's main ride-hailing business in China lock, stock and barrel in 2016, the Uber Eats' acquisition by Zomato is perhaps an indicator of Indian businesses' growing confidence in their own models and the ability to compete and win against global biggies in its backyard.

Beginning of the gender fight in family-owned businesses: When one of Murugappa Group heirs, Valli Arunachalam, came out in the open against the family's male-dominated board for denying her a board seat in the group's holding company Ambadi Investments, she raised the flag for gender equality in family-run businesses. Though it is still early days in what could be a prolonged intra-family battle, Arunachalam's move is a welcome development because most family-run big businesses in the country are conservative and patriarchal, and often relegate female heirs to the peripheries of the business, allowing them into the sanctum sanctorum only in the absence of a male heir.

Open like this!: It doesn't sound like a big deal, but one can't remember the last time a sector as regimented as coal — the bedrock of power and many a core industry —and a virtual monopoly of a state-owned firm, Coal India in this case, was completely thrown open by the government for all manner of people to come in when it cleared an ordinance on commercial coal mining earlier this month. Though they were liberalised sometime back, sectors such as insurance, banking, aviation, retail and even ecommerce still carry restrictions related to either foreign-capital, ownership or control. But not coal. Not on nationality, end-use, market restriction on who, how much and at what price can you sell. True, new projects will take time to fructify, and funding the venture will remain a challenge given coal's pariah status with many a marquee global investor.

Ignominy of a foreign investor: Whatever his reasons or compulsions, Union Minister Piyush Goyal's comments on Amazon, a big foreign investor, not doing the country "any favour" by committing another $1 billion was a first of sorts. Yes, governments are known to berate businesses, sectors and lobbies, but rarely do they single out individual firms for such public treatment, more so in a scenario where growth, investment and employment are all headed southwards. Whether one sees it is a mark of a rule-book-following government or a sign of nervousness depends on one's perspective.

India, from a buoy to a sinker: There was a time was when the country was the toast of the global community. It was feted as one of the global growth engines, bracketed in flattering acronyms and spoken as a counter-weight to China (remember Chindia!). That entire global aura somewhat dimmed when the International Monetary Fund earlier this month said that its downward revision in global growth for 2019, 2020 and 2021 is owed largely to downward revisions for India.

CHINESE WHISPERS

Joke turns almost true

Brazil President Jair Bolsonaro, though known for his tough statements, has stayed away from controversy during his India visit. A senior official of the South American country said its president had been advised to be on his best behaviour and, through the liberal use of humour and smiles, charm his hosts. This was on show during an industry summit on Monday, when Bolsonaro addressed business captains of both the nations. Being the last to speak, he approached the podium and sternly announced that lunch should be cancelled because the programme was running late. After an uncomfortable moment when the organisers mulled the fallout, Bolsonaro burst out laughing. While the audience got the joke eventually, many were baffled following the President's exit some time later when it was announced that lunch had indeed been postponed by an hour to accommodate more sessions.

A tepid press conference

The Congress on Monday announced it would hold a press conference daily at least until Saturday to "highlight the state of the Indian economy". The Union Budget will be presented on Saturday. On the first day of its series of press conferences, the Congress fielded a lesser-known spokesperson who had quit journalism to join the party and contest Lok Sabha election from a seat her father once represented. The press conference not only started 15 minutes late but evoked little interest, with few television cameras and reporters around to cover it. It yet again highlighted the trust deficit between the veterans in the party and some of the younger leaders who want Rahul Gandhi to return as party president. The spokesperson fielded by the party on Monday is considered close to the young leadership. Gandhi will address a public rally in Jaipur on Tuesday, when he will speak primarily on economic matters. The veterans, who have secured some significant gains, including in Jharkhand, Haryana, and Maharashtra, have their misgivings about his return.

Thank *tithi* for long weekend

Thanks to the confusion around the *tithi* (a lunar day in the Vedic calendar) to perform Saraswati *puja*, state government employees in West Bengal are expected to get a three-day holiday from Wednesday to Friday this week. Earlier, the government had declared a two-day holiday on Thursday and Friday but a recent circular stated that it had been observed that the *puja* could be held on Wednesday also. Therefore, the state government had decided to declare a holiday on January 29, in addition to January 30 and 31, as was announced earlier. The three-day holiday period covers all state government offices, urban and rural bodies, educational institutions, and other offices/institutions under the control of the state government except the Registrar of Assurances, Kolkata, the Collector of Stamp Revenue, Kolkata, and the West Bengal State Beverages Corporation Ltd, the circular said.

The corner store takes centre stage

To take on the might of Reliance and Flipkart, Amazon is taking a page from Alibaba's playbook in India

PEERZADA ABRAR

Besides holding closed-door meetings with top industry leaders, hobnobbing with Bollywood stars and visiting the iconic Taj Mahal, Amazon founder and Chief Executive Jeff Bezos did something unusual during his India trip this month. He delivered a package to a customer from a *kirana* store in Mumbai and shared the picture on his Instagram account.

Later, during a fireside chat with Bollywood star Shah Rukh Khan, Bezos described going to a *kirana* store as an "incredible experience." "It is this tiny little store. We have thousands of these points of presence now, where they do their regular business, but then they also provide a place for people to pick up their packages," Bezos told Khan. "I talked to this young man (at the *kirana*) who helps his parents to run the store, about how it has really improved their lives, to have that extra source of income. It was a moving experience."

TAKE TWO

ANALYSIS BEHIND THE HEADLINES

Delivering the package was not a random act by Bezos. It gives a sneak peek into the business strategy that Amazon is betting on to take on rivals such as Walmart-owned Flipkart and Reliance's e-commerce venture JioMart by merging online and offline retail. Only 7 per cent of the $1.2 trillion retail market is online and Amazon is eyeing the remaining 93 per cent of the industry, according to sources.

This month, Bezos announced that the company planned to invest $1 billion to help bring 10 million traders and micro, small, and medium enterprises (MSMEs) across India online, enabling $10 billion in cumulative exports by 2025. The firm also said it planned to create 1 million jobs in India by 2025 through continued investments in technology, infrastructure, and its logistics network. Amazon has so far committed $6.5 billion to the India market, including $1 billion announced this month. It is making these investments not only to tap the e-commerce market in the country, which is expected to touch $200 billion by 2028, but also digitalisation of small businesses including *kiranas* and in building its grocery and financial services business.

People familiar with Amazon's business strategy in India said that the company is looking at replicating the model of e-commerce giant Alibaba which has Hema stores and business-to-business retail platform Ling Shou Tong (LST) in China, to empower small enterprises in the country. The Seattle-headquartered firm is also looking at adopting the model of Canada-based Shopify, which sets up e-commerce websites for small businesses, and partners with others to handle digital payments and shipping.

"Globally, it is a strategic thing that they are doing from the last one year. It is about giving technology to small businesses to run the business, digitise them and create catalogues," said a person familiar with Amazon's business strategy in India. "It is like what Alibaba is doing in China with their LST platform and Hema stores."

In China, Alibaba is using LST, a retail-management platform to help mom-and-pop store owners optimise product procurement and boost sales. Jack Ma-led Alibaba is also quickly expanding its offline retail store Hema, which has gained popularity in China for its mobile-first approach to grocery shopping. Shoppers use Hema's mobile app to scan barcodes across the store to get information about the products and recipe ideas. Utilising neighbourhood stores as warehouses, Hema enables 30-minute delivery within a three-km radius.

"Mom-and-pop stores are really the future in India. When all the tier 1 and tier 2 cities are digitised, what remains are the tier 3, tier 4 and tier 5 cities and that is where all the action is going to happen. This also includes bringing large vendors who are not on their platform from these locations."

Last year, Amazon said it was on track to invest over $15 billion in 2019 in infrastructure, tools, services, people, and programmes to help third-party sellers succeed. This means Amazon profits when third-party sellers succeed.

One of the biggest challenges, though, that Amazon is aiming to solve to tap tier-3 and tier-4 cities and towns is last-mile delivery. In areas where the order volume is not high, it is not viable for firms such as Amazon or Flipkart to maintain warehouses.

"So, they are going to work with these *kirana* stores and use them as delivery and pickup points and also use some space as a warehouse," said Satish Meena, a senior forecast analyst at Forrester Research. "They don't want to lose out to Reliance, because Reliance is also trying to attempt the same thing. Amazon will certainly do something similar to Alibaba (in future). At this moment, they are taking the first steps to digitise the stores," said Meena.

PHOTO CREDIT: INSTAGRAM

EVERY NOOK & CORNER

$6.5 billion is Amazon's total commitment for India

- The money will be spent on digitising small businesses and on financial services businesses

$1 billion of this will be spent on bringing 10 million traders and MSMEs across India online

- It plans to merge offline and online retail
- Tier 2, 3 and 4 cities are the next frontier of growth

Amazon is also going to invest a large chunk of the capital to build the supply chain for its grocery and food category. "That is where you are seeing the competition coming up from Reliance, Walmart, Bigbasket and Grofers," added Meena.

A big part of its strategy is its financial technology platform to rapidly enable transactions online for small businesses and even provide them access to capital. "In the last 24 months, Amazon has poured in more than half a billion dollars into its Indian payment business. That's an indication of how competitive, the payment space has become in India," said Vivek Durai, founder of business signals platform Paper.vc.

Amazon and Alibaba have generally avoided direct competition by dominating different parts of the world. Salman Waris, managing partner at New Delhi-based specialist technology law firm TechLegis Advocates & Solicitors, said this could change as the two giants expand their footprint in India.

The two have taken different approaches to invest in India's growing economy. Waris said while Amazon is pouring billions into its branded marketplace, Alibaba has made heavy strategic investments in payment solutions and existing e-commerce businesses as it pursues a "super app" strategy in India.

Regardless, capturing market share and becoming profitable will require scale of business and vast amounts of capital, said Waris. "Amazon's present investment initiative is aimed exactly at this 'scaling up' and it has realigned its strategy by trying to help India's SMEs or *kirana* stores," said Waris.

ON THE JOB

Where are the jobs?

MAHESH VYAS

Employment takes many forms and a salaried job is only one of them. CPHS captures all forms of employment — whether it is formal or informal employment in the organised or unorganised sector; whether it is a salaried job or entrepreneurship in some form, even if the entrepreneurship is essentially self-employment. Today's gig workers would classify as self-employed entrepreneurs, for example. So would the typical Ola/Uber cab driver. CPHS is designed to cover them all — so long as they live in households in India.

The first observation we make is that the overall employment in India has been almost a constant at around 406 million since 2016. During the 12 Waves of CPHS conducted since January 2016, the total employment has been estimated at between 401 million and 412 million with an average of 406 million. The first Wave conducted during January-April 2016 estimated employment at 404 million and the last Wave conducted during September-December 2019 estimated employment at 406.5 million. Evidently, there hasn't been much movement on total employment over the four years since 2016.

Within this stable of 406 million employed persons, the share of employment for those less than 30 years of age has been declining. These accounted for about a quarter (25.6 per cent) of total employment in January-April 2016. By September-December 2019, their share had fallen to a little over a fifth (20.8 per cent). Those in their thirties also accounted for a quarter of the total employment in early 2016 and their share fell lesser to 23 per cent. Bulk of the employment is with those over 40 years of age. It was 49 per cent in early 2016 and their share has risen to 56 per cent in late 2019.

This ageing profile of India's workforce is as intriguing as it is disturbing. It is intriguing because India is a young country with 35 per cent of its working age population in the 15- to 30-year bracket. These young people carry the promise of the fabled demographic dividend. But, it is intriguing that their presence in the workforce has been shrinking. This structural shift in the age profile is also disturbing because an ageing profile is least capable of tackling with the challenges of new technology and an increasingly competitive business environment.

This ageing profile of the workforce is also prevalent in the salaried employees. Salaried employees include industrial workers, white collar workers, managers and support staff. It excludes farmers, traders, wage labourers and entrepreneurs.

We observe that salaried jobs have remained within a narrow band of 86 million and 88 million during this period. So, salaried jobs have accounted for around 21 per cent of total employment in the country. But this share has fallen a tad — from 21.7 per cent in 2016 to 21.4 per cent in 2019.

In 2016, 34 per cent of the salaried jobs were with people who were under the age of 30 years. In 2017, this proportion dropped to 31 per cent. Then it dropped to under 30 per cent in 2018 and, in 2019, it fell further to 29 per cent. This is not just a decline in relative terms. There is an absolute decline in salaried jobs for those under 30 years of age.

About 30 million people under 30 years of age had a salaried job in 2016. By 2019, this number dropped by five million to 25 million. This decline is as intriguing as it is disturbing. It is possible to assume for a moment that there is a decline in new salaried jobs available although even that is a bit incredulous. There has to be at least some increase in salaried jobs for those below 30 years of age.

This fall in the number of salaried employees and in particular young salaried employees or even those in their thirties with salaried jobs has implications on India's consumption growth story and also on its savings rate.

While salaried jobs have fallen a bit, the count of wage labourers and small traders has declined sharply from 173 million in 2016 to 131 million in 2019. On the other hand, the count of farmers and business persons has increased. The count of farmers has increased from 93 million in 2016 to 111 million in 2019. The count in entrepreneurs is bigger — from 52 million to 76 million. While there was an 18 million increase in farmers, there was a 24 million increase in entrepreneurs.

Wage earners are shrinking. In both, the organised and unorganised sectors. And, entrepreneurs are growing.

But it is worth noting here that the increase in entrepreneurship is of a kind that does not create salaried employment or daily wage employment. There is only one kind of employment that can do this — self-employment. The count of self-employed shot up by 23 million from 33 million in 2016 to 56 million in 2019. Their share in total employment has increased from 8 per cent in 2016 to nearly 14 per cent in 2019.

Entrepreneurship is vitally important for India's growth but, these enterprises need to grow beyond merely being means of self-employment.

The author is managing director & CEO, CMIE

LETTERS

The big question

The decision of the Union government to transfer the investigation into the Bhima Koregaon cases to the National Investigation Agency (NIA) — without consulting the Maharashtra state government led by Shiv Sena — and the resultant grave threat it poses to the concept and spirit of federalism is a matter of grave concern. The fact that the decision to hand over the probe to NIA came a day after the Maharashtra government reviewed the charge sheet filed in the cases had raised more questions than they answer. Investigation by the Pune police saw several human rights activists and lawyers who, labelled as "Urban Naxals" by the Bharatiya Janata Party leaders being named in the charge sheet and the judiciary took cognisance of the matter. The intervention by the Centre through the NIA at this critical juncture by riding a roughshod over the police powers of the state is wholly unwarranted. Not only does the credibility of NIA as an independent investigation agency come under a cloud, but the move also raises question marks on the commitment of the government at the Centre in upholding the spirit of cooperative federalism..

M Jeyaram Tamil Nadu

Missing the target

This refers to "Budget 2020: Govt unlikely to offer relief on Income tax" (January 27). It was intriguing to learn that the tax collection (both direct and indirect taxes) may fall short by ₹2 trillion this fiscal owing to the continued sluggishness in the Indian economy. As revealed in this report, the likely shortfall in respect of personal and corporate taxes might be as high as ₹1.5 trillion with the share of the goods and services tax also being a staggering ₹50,000 crore. As regards these twin direct taxes missing the targets, it seems that the FM had not done her homework before ushering in the cuts in the corporate tax rates last year.

Sadly, the much publicised revisit of the personal income tax regime — based on the recommendations of a direct taxes committee report — may also turn out to be a bubble getting burst on its own, as the FM may take some convenient shelter behind the depleted tax collection vis-a-vis the budgeted targets. But who may be held responsible for such a poor show? Moreover, why not wisely fix some realistic targets while preparing the Union Budget? It, however, may not be a surprise if the golden goose, the Reserve Bank of India, is once again pressurised into parting with a share of its most prudently maintained (read preserved) reserves. Where are we headed? Towards achche din? For whom?

Kumar Gupt Panchkula

Plain politics

This refers to "Locust attacks have links with climate change" by Sunita Narain (January 27). If this is read by our political leaders from different regions, it might nudge them to take some proactive measures to bring

down the losses for the poor farmers in Rajasthan and Gujarat. However, the poor "locust" has come handy for the opposition Bharatiya Janata Party (BJP) in Rajasthan. A BJP MLA, Bihari Lal Nokha, entered the state Assembly carrying a basket of locust — a unique way of protesting and drawing the attention of the Congress government there. Hence, locusts have turned into a fodder for the political slugfest between the two sides. There is a good chance that the BJP would take it to the next level and claim that it is a conspiracy to tarnish its image.

N Nagarajan Secunderabad

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HAMBONE

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Don't reduce devolution

Increasing grants and tied funds not enough

In recent decades, the responsibilities associated with running a state government have increased considerably. A greater political emphasis on the services that state governments can and must provide has become the norm. This has naturally been associated with the increased devolution of the tax pool to the governments that are the primary interface of the citizen and the Indian state. The Fifteenth Finance Commission is reportedly set to reverse this trend. It is likely, according to a report in this newspaper, that the existing share of the divisible pool of taxes that is set aside for state government spending — 42 per cent — may be reduced. This does not take into account any changes to the divisible pool itself. That too might be reduced following a late addition to the terms guiding the Finance Commission, which was asked to consider the needs of defence and national security as having a separate claim on national resources.

Given that defence is the Union government's responsibility, the Commission would naturally reduce the divisible pool. Put together with a reduction in the untied transfers to states, this would amount to a considerable reduction in the freedom to manoeuvre for state governments and their abilities to provide services.

This is not the direction in which India should be moving. While the Commission may seek to claim that increasing the "tied" funds — resources associated with specific Union government programmes and initiatives — might serve as compensation, it does not in fact amount to the same thing. State governments are directly accountable to the people for the services that they provide and should be able to make decisions on their governance with required resources in hand. Politicians at state levels are expected by their electorates to be the providers of essential services, and they justifiably expect, in turn, that this democratic momentum be reflected in the resources made available to state governments.

The Union government will no doubt argue that it has seen a crunch in its own resources, after the introduction of goods and services tax (GST). But it cannot blame anyone but itself. It has the primary responsibility for growing the size of the economy, and economic growth stalling is one essential reason for the reduced tax collection. The states themselves can also complain about GST, pointing out that they have signed away their powers to raise some indirect taxes, and that a reduction in the pool of divisible taxes is not a good way to reward them.

It is also important to consider the political circumstances in the country in general. Multiple stresses have emerged on the federal structure of the country in recent years. The widespread unwillingness on the part of state governments to implement the Citizenship Amendment Act is only one such stress. Others include differing demographic pressures and the consequent changes in relative political power across geographies of the country. It would be unwise from the standpoint of national interest to alter the decades-long momentum towards greater financial resources for states.

Air India's new deal

Despite better terms, finding a buyer may still be a challenge

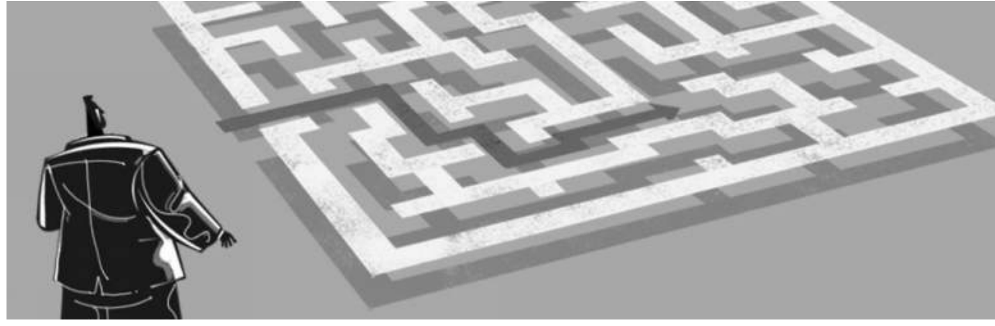
The government's second attempt to sell national carrier Air India, worked out by a committee headed by Home Minister Amit Shah, reflects a partly constructive attempt to correct weaknesses in the earlier bid document. First, in place of the earlier plan to disinvest 76 per cent in Air India and Air India Express, the government is now offering a 100 per cent sale, giving the prospective new owner much-needed operational freedom. In its ground-handling facility AI-SATS, the government is offering its 50 per cent stake (Singapore-based SATS owns the rest). Second, the new preliminary information memorandum, or PIM, also lowers the debt component that the new owner will have to shoulder to ₹23,286 crore against ₹33,392 crore in the earlier bid documents, limiting the buyer's debt to the cost of acquisition of aircraft that the airline will continue to operate. The government, thus, will bear the entire working capital and non-aircraft debt.

Taken together with valuable bilateral rights, which will be retained by the buyer as was done when British Airways, Lufthansa, and Qantas were privatised, the new deal is admittedly an improvement on the earlier proposal. The country's second-largest airline by market share has a fleet of 128 aircraft, 70 of them owned by the airline. More importantly, the new owner can take advantage of the 4,486 domestic and 2,738 international slots and code share agreements with 25 airlines that the flag carrier currently enjoys. The government's assurance that the terms of selling will be tweaked on the basis of suggestions from potential investors signals that it will be responsive to market expectations.

The question is whether the sweeteners are sufficient to entice a buyer at a time when the aviation sector is under stress worldwide. Indeed, against a robust intangible and tangible asset base, the critical problem of Air India's bloated workforce remains. It has 13,629 employees and one of the worst employee-to-aircraft ratios in the industry at 133 (for comparison, IndiGo's is 108). The Shah committee had indicated a one-year lock-in period, after which the buyer could offer a voluntary retirement scheme, but this remains a significant prospective cost for any new owner. The presence of 11 powerful unions certainly complicates the issue, and it is possible that the government will have to bear at least part of that burden as well. There is also some uncertainty over the issue of trademarks, including the famous Maharaja logo. The PIM states that the period for which they need to be retained will be declared in the request for proposal, which will be issued after March 31, after qualified bidders have been selected. Given that branding is the key in the airline business, the need for greater clarity on this would have gone a long way towards attracting bidders.

Finally, the timeline the government has proposed to close the deal also appears challenging. Bidders will have to submit their offers by March 17, and the qualified bidders will be notified by March 31. The reason for the government's haste to complete the deal before the end of the current fiscal year is understandable in the light of its inability to meet the ₹1.05 trillion disinvestment target. It is, however, difficult to see how any bidder will be able to complete a due diligence exercise in this timeframe or even agree to do so. An extension in this long-delayed process is, therefore, more than likely.

ILLUSTRATION: AJAY MOHANTY



Calibrating the policy mix

The right fiscal–monetary–external balance must be achieved to nurture and harness a nascent recovery

After a challenging few months, first light is emerging at the end of the growth tunnel. The recent high frequency data — whether power demand, cargo and railway traffic, industrial production, or the Purchasing Manager Index surveys — are either showing signs of stabilisation or some lift on a sequential (month-on-month) basis. But this will not show up any time soon in the year-on-year data, which is far more sluggish and doesn't capture turning points well.

Year-on-year growth in the October-December quarter is tracking 4.5 per cent — the same as last quarter — and may even print a tad lower. Prima facie, this will suggest no respite from the slowdown. In fact, however, a year-on-year print of 4.5 per cent would be signalling a sequential growth (quarter-on-quarter, seasonally adjusted and annualised) pick-up to 5.5 per cent in the October-December quarter from 3.5 per cent the previous two quarters.

Yet, it's too early to believe the corner has been turned just yet. Some of the lift is likely because of a series of one-offs (a postponement of consumption on goods and services tax, or GST, uncertainty in September and unseasonal rains that hurt mining and electricity production) have corrected. Only when growth stabilises at the 5-6 per cent level sequentially for a couple of quarters will there be conviction a corner has been turned. Furthermore, any lift is likely to be bounded given different balance sheets in the economy. Consumption has been the prime mover in recent years, but with individual debt rising, households have become risk-averse in the wake of the slowdown, manifested in falling consumer confidence in recent surveys. Meanwhile, financial sector balance sheets have thwarted the Reserve Bank of India's (RBI's) monetary easing cycle in 2019 from permeating to the broader economy. Lending rates have only come down a fraction of policy rates and inflation, such that real lending rates have actually increased over the last year. This helps neither household consumption nor corporate deleveraging.

Given these cross-currents, policy will have to perform a delicate balancing act in 2020. Fiscal policy, in particular, will have to walk a tightrope between avoiding pro-cyclicality yet simultaneously pursuing prudence. Government spending has grown twice as fast as other components of demand in recent quarters, and, therefore, played an important counter-cyclical role in propping up growth. But with real and nominal growth slowing precipitously, tax buoyancy is understandably under pressure. With the Centre's tax collections (net of the state share) estimated to undershoot budget targets by about 1.5 per cent of gross domestic product (GDP), sticking to this year's deficit target of 3.3 per cent of GDP, will likely entail a sharp cut in government spending in the last quarter of the fiscal year — which would constitute a formidable headwind to a fledgling growth recovery. Against this backdrop, it's understandable if authorities were to use the 0.5 per cent of GDP space accorded under the FRBM Act, and let the deficit widen towards 3.8 per cent of GDP. This should be seen more as the Budget's "automatic stabilisers" being allowed to work on the revenue side, rather than a fiscal stimulus in the form of the underlying structural deficit widening.

SAJJID Z CHINOY

If, however, the deficit does widen to these levels, it's important to show credible, if gradual, consolidation next year. India's yield curve remains steep— despite the growth slowdown, a sustained monetary easing cycle, and a gush of inter-bank liquidity — more confirmation it's an equilibrium response to the difference between public sector borrowing requirements and household savings, with foreign interest in India's bond market remaining muted in recent years. Against this backdrop, it will be important to show a credible consolidation to anchor bond market expectations, and avoid an inadvertent tightening of financial conditions.

But if fiscal policy is tightening next year, wouldn't that hurt growth in 2020-21? Not if that consolidation is achieved through asset sales. If asset sales were to rise from, say, 0.3 per cent of GDP to, say, 0.8 per cent of GDP next year, and the deficit is consolidated by, say, 0.3 per cent of GDP next year, the underlying fiscal impulse will actually be expansionary, even as the headline deficit is narrowing. From the perspective of macro management, one cannot think of a more appropriate time to step on the asset-sale pedal.

Finally, fiscal space created should ideally be spent to generate the highest possible fiscal multipliers. This would include spending that directly impacts the bottom of the pyramid (NREGA, PM Kisan) where the marginal propensity to consume is the highest, or temporary indirect tax-cuts to sectors with large multiplier effects (e.g. real estate sector) to stoke and bring-forward demand. New infrastructure spending has large positive spill-over effects, but its gestation often makes it impractical to serve as an urgent counter-cyclical response. All told, fiscal policy will have to perform a delicate balancing act, striving to remain counter-cyclical without inadvertently turning counter-productive.

But if fiscal policy must face trade-offs, monetary policy is not far behind. The sharp growth and inflation slowdown in 2019 allowed the RBI to slash policy rates to support growth. But the recent food price surge is creating policy trade-offs. While the focus is on vegetable prices, the real story is food inflation (ex-vegetables) has firmed from less than 1 per cent in 2017 and 2018 to almost a 7 per cent annualised momentum in recent months. Is this because of a temporary supply disruption from the unseasonal deluge last year? Or is it a more organic supply response to muted prices in recent years (Cobweb Cycle)? Or is some of it from firming global food inflation, which is in double digits? The answer to these questions will likely shape the inflation and monetary policy — trajectory for 2020.

There are other considerations. While firming food prices could harden urban inflation expectations, they will help correct the agrarian terms of trade that have been declining for a decade. To the extent that the resulting food inflation is not completely offset by the quantum of any supply shock, agrarian purchasing power and consumption should lift. Think of this as a transfer of purchasing power back from urban to rural.

But the trade-offs don't end there. With growth slowing, India's current account deficit is tracking just 1 per cent of GDP. Simultaneously, capital inflows have increased as global financial conditions have eased and Indian firms seek to raise capital overseas. This is resulting in a large balance of payments surplus. The RBI has correctly intervened to prevent rupee appreciation so that tradable sector competitiveness is not impinged. But this intervention creates a large liquidity surplus which can complicate monetary management if inflation firms. The RBI could intervene in a liquidity-neutral manner in the forward market, but that could disincentivise economic agents from hedging their dollar exposures, creating financial stability concerns down the line. There are no easy answers and this is the classical "trilemma" that emerging markets must contend with. Ultimately, more instruments (like macro prudential measures) may be needed to address multiple objectives.

Policy-makers must be commended for a slew of pronouncements in recent months to arrest the slowdown. There are first signs that growth is inflecting. Now, policy must calibrate the fiscal-monetary-external mix appropriately to nurture and harness a fledgling recovery.

The writer is chief India economist at J P Morgan. Views are personal

China and the West race to the top

Over the last 25 years, the relative growth rates of the world's major economies have changed dramatically. Six developing countries in particular —China, South Korea, India, Poland, Indonesia, and Thailand — have grown extremely fast during this period. The rich G7 countries, on the other hand, have experienced slowing rates of labour productivity growth, and their combined share of world gross domestic product (GDP) has fallen from two-thirds to one-half.

Neoclassical growth theory, which has dominated economic thinking over this period, has not been able to explain this reversal of fortunes. For anyone who has watched South Korean and Chinese firms triumph in one world market after another, it is difficult to believe that Western countries will be able to compete more effectively in the future simply by making their own markets more efficient.

DAVID SAINSBURY

If the developed world is to boost its competitiveness, we in the West need to embrace some new economic thinking. That means gaining a better understanding of the growth process, and using this knowledge to develop policies that can help accelerate it. Moreover, we should not think that we can acquire this knowledge by building ever more complex and unrealistic mathematical models.

A good place to start is with the measurement of national wealth, and the fact that a country's GDP per capita is simply the sum of the value added per capita of all its economic organisations, mainly firms.

We then need to ask how firms increase their value added per capita. In the observable world, rather than the world of perfect competition embraced by neoclassical economists, companies can do this in two ways. They can increase their production efficiency, as Henry Ford did when he started using an assembly line to manufacture cars, or increase the competitive advantage of their products, as Steve Jobs did when he developed Apple's iPhone.

Both Ford and Jobs increased the competitiveness of their firms by innovating. Countries like China and Singapore have done the same, helped along by lessons from more advanced economies. Both have declared themselves to be innovation nations, and have put innovation at the heart of government policy.

Western countries, therefore, need to understand three things in particular. First, they must increase their rates of innovation in order to compete better against fast-growing emerging economies. That will require them to develop policies that strengthen national systems of innovation, education, and training, and improve the governance and financing of their firms. Municipal- and regional-level policies should support these goals.

Second, the West needs to understand that there is a global ladder of economic development, the rungs of which represent increasing levels of organisational and technological complexity, and value added per capita. It is difficult for any firm to gain a competitive advantage in activities such as manufacturing cheap clothes and assembling electronic components, resulting in low value added per capita, and thus low wages and salaries. By contrast, companies in industries such as aerospace and pharmaceuticals can build up significant competitive advantages, leading to high value added per capita and consequently high wages and salaries.

Developing countries are rapidly moving up the ladder, and are increasingly competing directly with developed economies. The latter therefore must innovate rapidly both to increase the value added of their current industries, and to move into new high-value-added sectors.

Finally, Western firms and policy-makers should understand that their countries' competition with China and other rising economic powers is now a "race to the top," not a "race to the bottom" in which cheap labour and a "favourable" exchange rate are seen as the best ways to achieve and maintain competitiveness.

If developed countries can move further up the ladder of economic development by innovating and creating new high-value-added products and services while ceding lower value-added areas of activity to developing countries, then all can increase their national standards of living at the same time. If the pie is larger, everyone can have a larger slice.

To be sure, macroeconomic stability and efficient markets, which lie at the heart of neoclassical economic thinking, remain essential conditions for growth. But they do not drive it. If we in the West want to compete effectively against China and other fast-growing Asian countries, we need to understand that innovation is the engine of growth, and governments need to make it central to their economic policies.

The writer, a member of the British House of Lords and Minister of Science and Innovation from 1998 to 2006, is the author of Progressive Capitalism: How to Achieve Economic Growth, Liberty, and Social Justice. © Project Syndicate

A radical reset for the Indian economy

BOOK REVIEW

SUBHOMOY BHATTACHARJEE

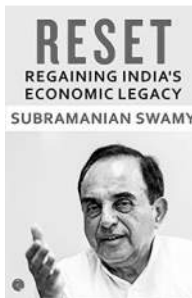
He gets the history right, the analysis spot-on, the target just about right but insists on a plan of action to achieve it that is a gamble even bigger than demonetisation.

Subramanian Swamy argues the Indian economy needs to grow close to 10 per cent per annum for at least a decade to make a dent on poverty, on unemployment and reach the league of middle-income economies.

To achieve this massive growth rate, Mr Swamy offers a menu of options that will upend the Indian economic administration and much else, irrevocably. It will also push the economy on a somewhat mercantile trajectory with huge risks of failure. That is the title of his book; *Reset: Regaining India's Economic Legacy*.

Mr Swamy suggests doing away with income tax, moving to a fixed exchange rate of ₹50 to a US dollar "and then gradually lowering the exchange rate for subsequent years", and offering a rate of interest of 9 per cent for fixed deposits in banks to incentivise savings and push investment. Yet later on (page 166) he acknowledges that India is now committed to a floating exchange rate and argues for only intervention instead of pegging it to a fixed rate. It is unclear which one of the options one of India's most famous economists would suggest the government should take.

It is also unclear how a state that will be made more or less bankrupt by eliminating personal income tax and financing a pegged exchange in an environment of hugely loose monetary and fiscal policy environment will be able to generate resources to finance the massive infrastructure support for building cities and in agriculture. He suggests keeping the Reserve Bank of India (RBI) printing presses open to keep financing this deficit, "setting aside concerns about the fiscal deficit ratio in the cold storage for the time being". Why this will not lead to inflation is, again, not quite evident.



REGAINING INDIA'S ECONOMIC LEGACY
Author: Subramanian Swamy
Publisher: Rupa
Price: ₹595
Pages: 189

Mr Swamy expects the bill to finance the impact of such a reset will be made good by exports which, in turn, will become competitive on the back of the manufacturing sector supplied with cheap capital gathering steam. While he contends, rightly, that the successive five-year plans often took no account of the weakness of the Indian economy by "squeezing agriculture through taxes, terms of trade...to raise funds for financing the industry", his mantra also glosses over some of the festering weakness of the economy, such as an uncompetitive manufacturing sector that needs far more than cheaper capital and difficult centre-state relations that will make any such bartering away of tax revenues a non-starter. He describes his blueprint as "an alternative ideological thrust", and like all ideologies makes light of any opposition to it.

This is unfortunate because he makes several valid points in his analysis of the problems besetting the Indian economy. For instance, he maintains that there is a need to "cajole the stakeholders in the economy to get enthusiastic about economic activity and be incentivised for it"— the animal spirit problem. Mr Swamy is also spot on about the causes for the decline in household savings rate and the rise in rural indebtedness as also about demonetisation, which he terms as a monumental blunder. "It had a major negative effect on small businesses, workers and farmers, while leaving the rich virtually unaffected because of the class' ability to rig the system".

But then, from there he jumps from these to suggest, "The government will therefore have to stimulate the economy by monetary and fiscal measures. These will have to come from radical, out-of-the-box and rational risk-taking on intuitive thinking". One would instead suggest that in Budget 2020, the finance minister should settle on conservative measures for economic revival instead of walking on a risk taking path that Mr Swamy suggests. He does not countenance that his more sane advice for large-scale privatisation, reform of the financial sector and "synchronisation with the WTO", which possibly mean keeping customs duty low are by themselves good enough to take the growth rates quite high.

As he rightly says in the Modi government's two spells, "till date, deregulation measures have been confined to the central government and even here it has been piecemeal". He also suggests land consolidation through market forces for agriculture. In fact, his list of reforms for this sector including wider adoption of land leasing, more public investment including in warehouses and formation of an agriculture advisory service are most unexceptionable.

Reset, thus, is not much of a reset as much as setting of the lines of sound policies for the government to adopt, once the extravagant bits are edited out.