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The taper without a tantrum

That it stood its ground and seemed convinced about another rate hike in the rest of the year seemed to indicate the Fed was in a 'hawkish' mode

WORLD MONEY

ABHEEK BARUA & BIDISHA GANGULY

The US Federal Reserve delivered its expected quarter point hike in interest rates last Wednesday. Currency markets did respond to the Fed move despite the claim by many analysts that it was all "priced in" earlier, although nowhere as vehemently as during the taper tantrum of 2013. The US dollar gained against a number of G-7 currencies like the Euro as well as a basket of emerging market currencies. On the whole, the Fed successfully portrayed itself as serious about unwinding liquidity at a steady pace without an adverse market reaction. One should remember that Ms Yellen's tenure will come to an end in February 2018 and it is important for her to establish her credibility as a tough monetary boss.

The fact that the Fed stood its ground, hiked the rate and seemed reasonably convinced about another rate hike during the rest of the calendar year seemed to indicate to markets that the Fed was in a "hawkish" mode. Besides, the clarity on liquidity withdrawal (that is the reversal of Quantitative Easing) appeared to have strengthened this view. For a currency like the USD that has been mercilessly beaten down over the last few months, this was reason enough to spur buying. This pushed the dollar up against a number of currencies and led the much-tracked dollar index (a basket of key exchange rates against the dollar) to climb up quite a bit from around 96.5 before the Fed announcement to close to over 97.5, a respectable gain by any standards. The rupee too lost a fair bit and on Friday morning crossed the 64.70 mark.

While Fed Chair Yellen indicated that the Fed remains confident about inflation rising to its target of two per cent over the medium term bolstered by a robust labour market many questions about the performance of the US economy continue to remain unanswered. For example, why has inflation remained weak even as the unemployment rate has fallen for successive months? Is the performance of the US economy indeed improving as indicated by the fall in the unemployment rate? The data print on growth has been disappointing so far while hopes for a fiscal stimulus are waning, as the political scenario is making it difficult for the administration to move forward with concrete policies.

Coming to the labour market conundrum, it is hard to explain why the unemployment rate has been falling steadily but there are no signs of acceleration in wage growth. A possible explanation can lie in demographic factors which have brought down the natural rate of unemployment (the rate at which inflation goes into a steady state, neither accelerating nor decelerating). This means that even with tightening labour market conditions, inflation pressures could remain soft putting the Fed in a perpetual dilemma.

So why did the Fed not only raise interest rates but also maintain its forecast of one more rate hike this year to be followed by three in 2018? The real reason may be to move ahead in the task of normalising monetary policy from a long period of extreme accommodation which outweighs any concern over recent economic data falling short of expectations. To this end, the Fed also laid out its plan for a steady reduction in its assets starting towards the end of this year. While the Fed has been extremely cautious on the planned reduction, the liquidity drain is bound to have an impact on asset prices going forward.

The rupee, which had appreciated significantly since the beginning of 2017, initially reversed direction much to the relief of those worrying about its competitiveness. The rise in India's trade deficit during April-May on the back of higher imports further supported the fall in the rupee. India's current account deficit is likely to widen this year.

By Friday evening however, the initial bang in the dollar index had turned into a bit of a whimper as the dollar index lost ground and the rupee moved back to 64.40. However, it is too early to write the dollar pop as a flash in the pan. Sudden reversals and rallies typically induce some desperate selling action that put a brake on these sudden movements. However, if there is a fresh round of gains in the dollar index, it might mean some weakness in the rupee going forward.

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CHINESE WHISPERS

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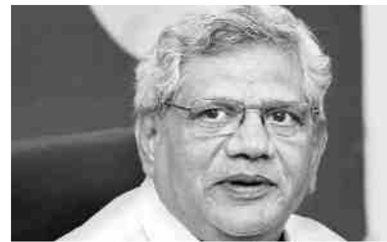

On Friday, the Communist Party of India (Marxist) headquarters at AKG Bhavan in New Delhi had unlikely visitors in Home Minister Rajnath Singh and Information and Broadcasting Minister M Venkaiah Naidu. The two were there to meet CPI (M) chief Sitaram Yechury (*pictured*) as part of the Bharatiya Janata Party's (BJP) outreach for the presidential poll. The two ministers visited the CPI (M) office that is now heavily barricaded and has increased security after Delhi Police, which comes under Singh's ministry, beefed it up subsequent to two Hindu Sena activists trying to attack Yechury earlier this month. Yechury had then pointed the finger at the Rashtriya Swayamsevak Sangh, the BJP's ideological parent, to be behind the attack. The CPI (M) leader who received the home minister reminded him of the reason for the increased security.

Cricket in the air

Visiting Jharkhand last week while the ICC Champions Trophy, 2017, was still under-way, Union Minister of State for Civil Aviation Jayant Sinha (*pictured*) explained how the industry and the government needed to cooperate to fulfill the country's infrastructure dreams borrowing instances liberally from the game of cricket. The government will prepare the pitch but industry must bat on it, Sinha said at a session on Momentum Jharkhand hosted by the state chapter of the Confederation of Indian Industry. "If you bat, development will come sure shot. *Par hamesha sarkar ki taraf dekhne se vikas nahi hoga* (development will not happen if you look at the government for everything)," he warned.

Poll bounty for Bengaluru

With the Assembly elections in Karnataka due in a year, its capital city has become the cynosure of all eyes. Chief Minister Siddaramaiah, who comes with a strong base in rural Karnataka and who has been accused of ignoring Bengaluru, the city famous for its chock-a-block roads and polluted lakes, has been launching new projects for the city almost on a daily basis. While President Pranab Mukherjee was invited to inaugurate the first phase of the metro amid much fanfare, the government announced the launch of cash cards not just for tickets to ride the metro and local buses, but also for some other government services. If political buzz can be relied on, the coming weeks promise more bounty for the city.

Transitioning tax credits under GST

Clarity is required for assessees to take necessary steps — in terms of readying supporting documentation where credits can be transitioned, and also negotiating with counterparties on who will bear sunk costs where credits can't be transitioned

ROHAN SHAH

With the goods and services tax (GST) looming, one of the biggest challenges that businesses are grappling with is the transition of existing tax credits. Such credits, once transitioned, can be used to pay GST on outward supplies. Credits that cannot be transitioned become a sunk cost for businesses, given that outward supplies will attract GST at the prescribed rates, but at the same time, a corresponding credit will not be available for offset.

The GST law contemplates two broad scenarios in which credits can be carried forward. The first is a currently registered assessee under the central/state laws, who can transition 100 per cent of the credit shown in his returns. The second is a currently unregistered assessee, who can transition 100 per cent credit for inputs in stock or inputs contained in semi-finished goods/finished goods in stock on the date of transition, on the basis of a duty-paying document issued within one year preceding the GST. Where such document is unavailable, the transition credit is limited to 40 per cent of CGST/SGST paid on the supply of the goods under GST (60 per cent where the collective rate of GST is 18 per cent or more, as in the case of mineral water, computers, cameras etc.). In both scenarios, transition of credits is permitted only in respect of goods/services which satisfy the dual condition of being eligible for credit under the existing rules, as well as being eligible for credit under the GST law.

Industry input on the transition provisions has already resulted in some relaxations — (i) the credit allowance was increased from 40 per cent to 60 per cent where the collective GST rate is 18 per cent or more; (ii) the time limit for declaring transition credits was increased from 60 to 90 days; (iii) traders will also be able to avail of credit basis a Credit Transfer Document (CTD) issued by manufacturers within 30 days of GST for distinctly identifiable goods above ₹25,000 (such as televisions, refrigerators, car chassis, engines etc.).

The government must be complimented on having been responsive to the changes that industry has sought. However, certain ambiguities and open issues remain. To begin with, there may be some assessees who fall into a gap between the two credit transition scenarios contemplated under the GST law. For instance, there may be excise-registered manufacturers who pay duty at a concessional rate on the condition that they do not avail of CENVAT (Central Value Added Tax) credits. There is no contemplation of how such persons can carry forward their existing credits, as they do not reflect the credit in their current returns, nor can they transition 100 per cent credits under the second scenario which is available only to unregistered persons.

Another major issue is for traders who had not obtained the optional first stage/second stage dealer registrations under excise (a not uncommon practice in the auto sector, among others). A number of these traders have recently applied for these registrations so that manufacturers can issue them excise invoices to enable a 100 per cent credit transition. Apart from the ground level challenges in obtaining these registrations in time, it is also unclear if traders can transition 100 per cent credits even for stock received by them prior to being granted the dealer registration, presuming that they are able to belatedly obtain a (revised) excise invoice from the manufacturer which the tax authorities accept.

Under the GST law, there is also no provision which speaks to a situation of pending disputes concerning the eligibility of credits under the current law. For instance, an assessee may have received an adjudication order or appellate order (subject to further appeal) ruling against his eligibility to avail of certain credit(s). Similarly, some assessees will have reversed credits under protest under the existing law, or reversed credits to pay mandatory pre-deposits required for filing an appeal. These credits may become available in the future if the outcome of the dispute is favourable to the assessee. The recoverability of such amounts under the GST, either in the form of input tax credit, or by way of refund, is unclear.

Given the proximity to the transition, complete clarity is required for assessees to take necessary steps at this stage — not only in terms of readying supporting documentation where credits can be transitioned, but also negotiating with counterparties on who will bear the sunk cost where credits cannot be transitioned.

The importance of addressing these open issues under the transition provisions is escalated by the fact that there is a single-window opportunity for assessees to properly harvest existing tax credits on the crossover to GST. Concomitantly, the right to credits which are not transitioned as part of this one-time exercise may potentially be extinguished.

ILLUSTRATION: BINAY SINHA

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BUSINESS LIFE

The decline of the baronial CEO

Changes in corporate leadership are recasting the very idea of industry in US

NELSON D SCHWARTZ

They bestrode the business world, or at least the suburban corporate campus, like a colossus. Sitting behind burnished wooden desks, in glass-walled corner offices like the one Jeffrey R Immelt occupied at General Electric's former headquarters here in Fairfield, Connecticut, a select group of American chief executives were once more akin to statesmen than businessmen.

GE moved out of this sprawling Skidmore, Owings & Merrill-designed emblem of 1970s corporate modernism in favour of smaller, humbler digs in downtown Boston last year. And last week, Mr. Immelt unexpectedly announced plans to retire after 16 years in the top job, amid a sagging stock price and pressure from activist investors.

General Electric is just the latest storied name in corporate America to show its leader the door. Ford's chief executive, Mark Fields, had been in the job for less than three years when he was fired in late May. Two weeks earlier, Mario Longhi of US Steel abruptly stepped down.

With these departures, the American era of the baronial chief executive, sitting atop an industrial dominion with all the attendant privileges, is drawing to a close.

It is one consequence of a transformed economic landscape in which many of the mega-corporations that defined 20th-century commercial life are confronting a host of new business and technological challenges. These changes — in corporate leadership, on boards and across Wall Street — are recasting the very idea of industry in America.

"The CEO with a big office, a tenure of 10 or 20 years, in a suit and tie, is becoming a thing of the past," said Vijay Govindarajan, who served as GE's chief innovation consultant in 2008 and 2009 and now teaches at Dartmouth's Tuck School of Business.

Mr. Immelt's exit from GE is particularly telling, given the its reputation as a training ground for the future chief executives of other companies. He tried to change GE, yet couldn't react quickly enough to the forces affecting companies like his.

These include the rising power of activist investors, who buy up stakes in companies and then demand changes. Activists are now hunting much bigger game, demanding double-digit annual earnings growth in a stagnant economy. Or else.

It is a reality only too familiar to John Mackey, the co-founder and chief executive of Whole Foods Market. On Friday, after pressure from activists — a group he had referred to in an interview days before as "greedy bastards" — Whole Foods was acquired by Amazon for $13.4 billion.

That deal also shows how the digital age has upended the competitive landscape, pitting companies in vastly different industries against one another.

"Who ever thought Ford would be competing with Google?" said Michael Useem, a professor of management at the Wharton School of the University of Pennsylvania who has studied corporate leadership for decades. "But they are, and Mark Fields wasn't moving fast enough."

Boards, too, have changed, evolving from country-club-like collections of the same familiar faces into a much more diverse and demanding constituency.

To be sure, the money is better than ever. And pockets of unbridled ambition and occasional excess remain, especially in Silicon Valley, where Apple's new $5 billion spaceshiplike headquarters opened in April.

General Electric CEO Jeffrey Immelt at the company's corporate headquarters in Fairfield, Connecticut. GE is just the latest storied name in corporate America to show its leader the door PHOTO: REUTERS

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LETTERS

Idea for future

With reference to "Now, Aadhaar must for opening bank accounts" (June 17), the piecemeal introduction of additional requirements for carrying out normal financial transactions makes citizens averse to innovations and helps middlemen make an easy buck for providing "services" which in the normal course should come free. Aadhaar, from the time the idea of "universal identity", has suffered from the absence of a "project approach" in implementation. Politicians, professionals, the government of India, the media and social activists have contributed in equal measure in confounding the confusion that was the twin of Aadhaar. At least at this stage, the government should professionalise further processes in the implementation of Aadhaar and restore its credibility in the minds of citizens.

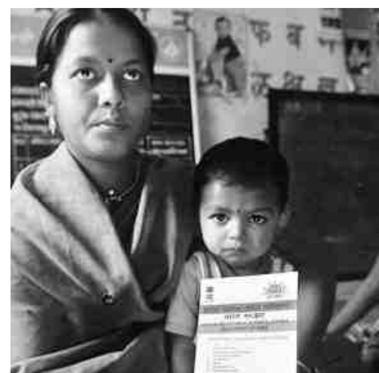
An all-purpose single identity number for each individual is a still sound idea for the future. That will solve number portability issues and minimise irritants such as problems arising from spelling changes in names, addresses etc. caused by outsourced service providers who manage compilation and processing of data.

M G Warrier Thiruvananthapuram

Aadhaar flip-flop

With reference to "Now, Aadhaar must for opening bank accounts" (June 17), earlier it was for direct benefit transfer schemes, then PAN linking and now it is bank account. If the government thinks that all other documents that are considered as proof of identity are useless then it would be better that it came out with a single ordinance that henceforth, no documents other than Aadhaar would be admissible for identity proof. Why go for frequent and piecemeal legislations?

Also, it shall be remembered that Aadhaar was introduced under the previous government when the current party in power had vehemently opposed it.



Now, the party is finding it a sacrosanct document and panacea for all ills of forged documents. What a change in stand from the role of opposition to power! This also brings out the fact that we simply act to oppose without going into the merits of actions of those in power and this mindset needs to change in the interest of our democracy.

Ajay Gupta by email

Seed price cut

With reference to "Hybrid seed prices cut by 10% for 2017-18 kharif season" (June 16), the Centre in consultation with the Commission for Agricultural Costs and Prices has just announced a modest hike in kharif minimum support prices (MSP) of pulses, oil seeds, paddy, maize and bajra. Pulses observe an increase of ₹350-400 a quintal while soybean MSP increases by ₹275 a quintal and paddy MSP by ₹80 a quintal. The hike in MSP and retail price cut by 10 per cent for hybrid seeds can be a welcome and timely move to protect farmers' interests and guard them against market swings. With decisions coming to effect from the 2017-18 kharif season, procurement agencies should fix their plan of work to cover as many small farmers as possible by offering adequate services and timely payment of procured quantities.

Retail price cut for hybrid seeds should not entice unscrupulous manufacturers to sell "untruthful-label" seeds to ill-informed farmers. The seed certification bodies can conduct random inspection at the points of sale. On the other hand, post-harvest management for pulses and grains should be scientific, in that market agencies can engage in improved warehousing and storage and promote warehouse receipt financing. Increase in MSP might motivate pulse growers to expand the area under cultivation or improve productivity. Nonetheless, fertiliser and pesticide prices should be well-regulated to meet farmers' budget. Else, they may not be able to reap a good return or their claim, "low profitability on farming", cannot be disproved.

Kushankur Dey Bhubaneswar

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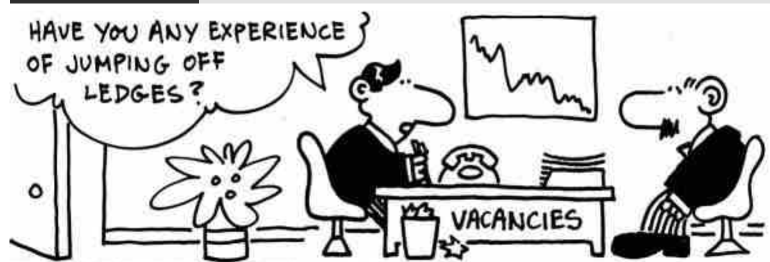
HAMBONE

BY MIKE FLANAGAN



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Don't fix telecom tariffs

Telcos' demand for a floor price is a bad idea

Reeling under growing debt and a huge strain on profitability, several telecom operators got together last week to seek a floor price for voice and data tariff. Operators across the spectrum — from Vodafone (a multinational) to Idea Cellular (an Indian private sector firm) to BSNL (a state-owned firm) — sought the attention of the Telecom Regulatory Authority of India (Trai) as well as an inter-ministerial panel, set up to hasten the resolution of financial stress in this sector. The demand for a floor was based on the argument that Reliance Jio's rock-bottom data tariffs, coupled with free voice calls and zero billing for the first six months, were the key reason for the financial stress.

A floor for tariffs, it was argued, would ensure that revenues did not get into a free fall anytime in the future. The older networks also demanded reduction in the charges that the government collected from them. Some even asked for an extension of the period over which they can pay the government for spectrum. However, Reliance Jio queered the pitch by telling the inter-ministerial group that the crisis was of the networks' own making as they had chosen to make investments through debt and not equity. And hence there was no need to give them a bailout package.

It is true that the quarterly revenues of older telecom networks have shrunk by up to 20 per cent after Reliance Jio launched in September. In fact, only one of the five listed networks, Bharti Airtel, reported a profit in the March-ended quarter. The various charges that the government collects on the adjusted gross revenues of the networks have also shown a decline. The fall in revenues has happened at a time when operators' debts have grown to over ₹4.5 lakh crore. The telecom sector is looking increasingly vulnerable from the standpoint of adding to the growing mass of bank non-performing assets (NPAs), and the Reserve Bank of India (RBI) has already advised banks to treat this sector with caution.

However, there are many reasons why the demand for a floor price should not be entertained. For starters, at a time when several other sectors are facing financial duress, acceding to fixing prices in one sector could trigger a similar demand from other stressed sectors such as steel, real estate, and mining. Moreover, setting a floor price is bound to breed inefficiency and slow the adoption of technology as it would disincentivise reducing costs through efficiency gains. Such a move would also impinge on the consumers' interest. Of course, if there is predatory pricing, the matter should be looked into by the Competition Commission of India. It is noteworthy that a similar situation had arisen around 2010, under the UPA government's first-served policy, when a host of new players had entered the market with very low tariffs. The average revenue per user (ARPU) of the incumbent networks fell sharply. However, the low tariffs proved unsustainable and slowly the ARPUs began to recover. No intervention from Trai was required. To its credit, Trai has so far stayed away from tariff fixation. It should continue to show forbearance in the future.

Bad timing

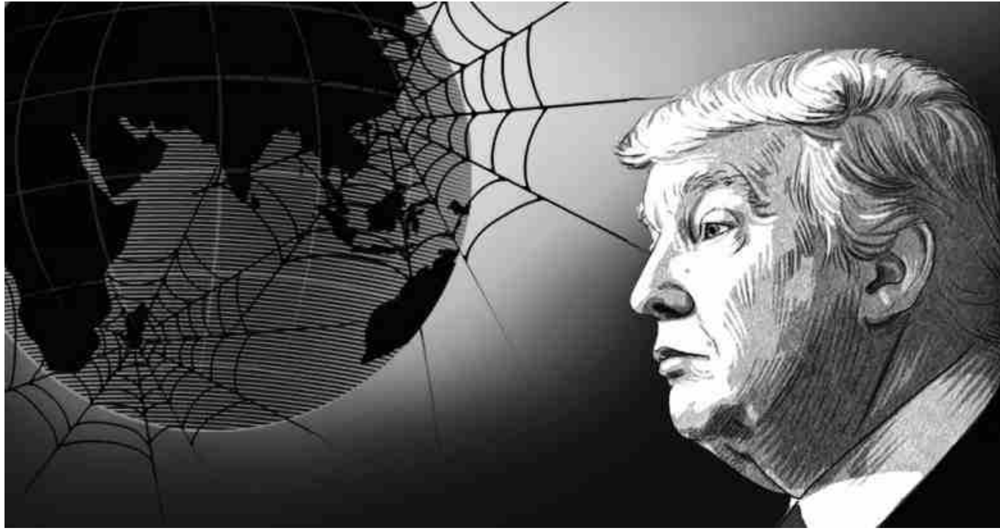
Farm loan waivers threaten to derail state finances

The chorus of farm loan waivers across several states has aggravated concerns about state-level finances. The trend, which started after Uttar Pradesh announced a farm loan waiver of ₹36,000 crore in March and got stronger with Maharashtra agreeing to a ₹30,500 crore waiver earlier this month, is indeed worrisome. Farmers in several other states such as Madhya Pradesh and Karnataka have also pitched for waivers. According to an analysis by *IndiaSpend*, the amount involved could be a staggering ₹3.1 lakh crore — big enough to fund the Prime Minister's Gram Sadak Yojana, a national rural road scheme, 16 times over. Although this latest episode of farm loan waiver started with Prime Minister Narendra Modi making such a promise in the run-up to the UP Assembly election, the central government has now sought to distance itself from any funding obligations. But the fact is that such waivers will impede capital expenditure in agriculture because many states are in no position to bear the burden. For instance, in UP's case, the waiver amounts to 2.6 per cent of the state's gross domestic product. For perspective, UP's fiscal deficit, according to the latest Budget, was pegged at 2.9 per cent of state GDP and the 14th Finance Commission had stipulated state fiscal deficits should not exceed 3 per cent of state GDP.

What makes this trend particularly worrisome is the timing. While the central government has notched up reasonable success in terms of achieving fiscal consolidation over the past four years, much of this good work has been undone by the slippages at the state level. In stark contrast to the trend at the central level, the combined fiscal deficit of states has risen from 1.93 per cent of GDP in 2011-12 to 3.6 per cent in 2016-17. This is the highest in the past 12 years. Till the last fiscal year, much of the expansion had happened on account of the growing capex expenditure. The big worry, especially during the last fiscal year, was the slippage on account of UDAY or the Ujwal Discom Assurance Yojana, which is a financial turnaround plan for state-owned power distribution companies. Farm loan waivers will only exacerbate this trend. Estimates suggest that if the fiscal slippage is not staggered over multiple years, it is likely to be 1.0-1.3 per cent of GDP in 2017-18. The Reserve Bank of India has made it a point to repeatedly warn against the inflationary impact of such fiscal slippages.

To be sure, even without the threat of waivers, states had enough reasons to worry about their finances. For one, state finances have not yet taken the full hit of the Seventh Pay Commission recommendations. As more and more states align with the pay increase at the central level, slippages will go up. The other big factor is the roll-out of the goods and services tax (GST) across the country from July 1. This, in turn, is likely to bring in a lot of disruption — not the least because many firms, especially the smaller ones, are possibly not yet ready for the GST regime. As such, there is little clarity on the impact the GST would have on states' revenue stream.

ILLUSTRATION BY AJAY MOHANTY



A scary new world?

The international economic and political order, led by the United States, is under threat from the Trump administration

Have the first five months of the Trump presidency taken us into a scarier new world of global economics and politics? I believe so.

In broad terms, the 70 years since the Second World War (WW2) saw the rise of a liberal international economic order (LIEO) for trade, capital flows and, to a limited extent, skilled labour. It also witnessed the economic development of emerging nations, many of which had been under colonial rule. The LIEO was buttressed by a set of international institutions, created under US leadership after WW2, notably the International Monetary Fund, the World Bank and the General Agreement on Tariffs and Trade (GATT) and its successor the World Trade Organization (WTO). GATT/WTO oversaw successive Rounds of multilaterally negotiated trade agreements, which gave a strong and sustained impetus to the post WW2 expansion of world trade, the principal driver of post war globalisation and a major propellant of unprecedented world economic growth.

A PIECE OF MY MIND

SHANKAR ACHARYA

The international political order that underpinned the LIEO was, mainly, the "Western Alliance" led by the United States (the strongest victor of WW2) and including Western Europe nations and Japan. Many have characterised these seven decades as "Pax Americana", since American economic, political and military leadership was clearly dominant, especially after the fragmentation of the Soviet Union in 1991. Pax Americana was not all about peace and prosperity. In pursuit of her interests, America fought long and ruthless wars in Indo-China, Iraq and Afghanistan and intervened both overtly and covertly in several countries of Latin America and West Asia. But it has to be acknowledged that Pax Americana and the LIEO helped foster an unprecedented surge of international trade and economic prosperity across most of the developed and developing world. Amongst the principal gainers were nations of Europe and East Asia, with one of them, China, experiencing sustained hyper growth to become, in recent years, the second largest national economy and a challenger to American hegemony.

Pax Americana and the LIEO were already under stress from various factors and forces since the last decade. These included: growing cross-border Islamic-jihadist terrorism, including the "9/11" airliner attack in the US in 2001; the long wars in Afghanistan (the "war of necessity") and Iraq (the "war of choice"), the Global Financial Crisis and the associated Great Recession of 2007-9 and their prolonged negative consequences on growth of output and trade in major countries; the increasing economic inequality and associated political polarisation within the US and several major European nations; the surge in refugees from West Asia and North Africa as their home countries were devastated by civil strife and/or Western armed intervention; the extraordinary rise of China as a new great power as well as its recent economic slowdown; and all the ramifications of Brexit.

Despite all these major stresses and strains, the global economy and world trade had begun to pick up steam over the past year. The Paris Agreement on policies to combat Climate Change, weak though it was, did get concluded in late 2015 and entered into force in November 2016. The Trans-Pacific Partnership (TPP) agreement (a "super" regional trade pact) was concluded in February 2016.

All this changed with the inauguration of Trump as President on January 20. Consider some of the policy actions and announcements of the Trump administration in the last five months.

Global Trade: America withdrew from the TPP within 3 days of the inauguration, vastly diminishing her potential role in Asian economic affairs and leaving the field for dominance by China. The threat of renegotiating the North American Free Trade Agreement continues. There has been a spate of anti-trade pronouncements by Trump and his cabinet officers, all of which demonstrate a clear preference of bilateralism over multilateralism. Although the initial threat of a US-China trade war appears to have receded, it might be revived at any time. There has been little by way of support for the WTO and its principles of non-discriminatory, multilateral trade; or for international calls against trade protectionism.

Peace and Security: Perhaps the biggest blow to the Western Alliance, the key platform supporting Pax Americana, was delivered during the NATO summit meeting in Brussels in late May, when Trump failed to give the customary endorsement of the treaty's article 5, which binds all NATO allies to come to the aid of any member under attack. This was followed by his equivocation on the Paris climate accord at a lacklustre G-7 summit two days later. German Chancellor Angela Merkel subsequently mused that Europe could no longer depend on America. A few days earlier Trump had decisively sided with his Saudi Arabian hosts in their long-running rivalry with Iran, portraying Saudi Arabia as a bulwark against jihadi terrorism, despite the kingdom's long record in exporting Wahabi fundamentalism across the globe for 40 years. By aligning so closely with one side of the long-running Sunni-Shia schism, Trump may have stirred up more future terrorism challenges for the US and the world. Trump's endorsement of the Saudis and their close allies may have also helped precipitate the ongoing crisis over Qatar (which hosts a major American military base), on which US policy statements (and presidential tweets) have been confusing, to put it mildly.

Global Public Goods: In the past, America has typically played a leadership role in organising actions and funding for global public goods. On June 1 Trump announced withdrawal of the US from the Paris climate accord, thus majorly weakening the fight against global warming and climate change. His administration had already issued a series of executive orders liberalising regulations for coal mining, pipeline building and so forth, in effect reversing anti-carbon actions taken by the Obama administration. The prospects for American leadership on other public goods such as protection of the oceans and the battles against communicable diseases look bleak.

Little wonder that John Ikenberry (Professor of International affairs at Princeton) writes "the world's most powerful state has begun to sabotage the order it created. A hostile revisionist power has indeed arrived on the scene, but it sits in the Oval Office, the beating heart of the free world." *(Foreign Affairs, May-June 2017).*

The writer is former Honorary Professor at ICRIER and former Chief Economic Adviser to the Government of India. Views are personal.

We can't afford to lose farmers

It took the tragic death of six farmers in Madhya Pradesh for the national media to report on the deep-rooted agricultural crisis. The farmers who were killed in police firing during protests were demanding that the government pay a higher minimum support price (MSP) for their crops. But it is not only in Madhya Pradesh that farmers are out in the streets. Agricultural unrest is worse in the more prosperous and productive regions, where the input cost of farming is higher and so is the debt. Farmers are bleeding. Enough is enough, they are saying.

DOWN TO EARTH

SUNITA NARAIN

The current crisis is about the problem of plenty. The crop production this year has been good, but the farmers are in trouble because the glut means that the value of the crop has gone down. After seasons of bad yield (caused by rain failure or variable and extreme weather), this is the straw that breaks the camel's back. The bumper crop could have helped them make good their losses and pay their loans. Their despair should make us act.

There are many issues here. First, how will the country pay higher prices for crops? We also need to keep the food inflation rate low because the high cost of food would make consumers unhappy. It is also a fact that India has a vast number of really poor people. The government's food procurement — buying from farmers and providing it to people through the public distribution programme — keeps the country away from famine-like situations.

So, the government is caught between a rock and a hard place. On one side are farmers, who need to be paid the right price for growing food, and on the other side are people (including thousands of farmers) who cannot afford expensive food. As yet, the policy has been to subsidise food, not pay farmers. That's what MSP is all about.

The second challenge is how to price agricultural produce. For farmers, MSP is an insurance against price volatility. But it is set for 22 food crops only. Of these crops, governments primarily procure paddy and wheat at MSP. But the MSP mechanism needs to be reworked. In fact, the costing of food needs to be reworked, indeed understood, in its totality. We know that input costs are reducing farmers' earnings. We also know that farmers are faced with increasingly variable weather, which leads to crop losses. So, we don't know what investment a farmer makes to provide us food.

Governments and market economists argue that MSP has increased over the years. They say, it is because of this increased cost of procurement that agricultural productivity has jumped. But they miss the fact that the cost of production cannot be computed only on the basis of how much money was spent to grow a particular crop. It has to take into account the enormous risks that farmers take, like the extreme variability of weather and freak events that destroy crops every year. Then why should the costing not include the cost of infrastructure required to grow food? Indian farmers invest huge amounts of private capital in building the infrastructure for their operations, unlike any private company or industry. They pay for building irrigation facilities — more than half of the irrigated land uses groundwater. Some 19 million wells and tube wells have been built with private capital.

This discussion on the cost of food must also take into account two deadly distortions. One is the difference between the price that a farmer is paid for his/her produce and the price at which consumers like you and me buy it. It is widely known and accepted that this gap is increasing. It is also known that this price disparity is due to a combination of factors, from restrictive laws over sale of agricultural products to lack of facilities and infrastructure for storage, transportation, and direct sale to cut out intermediaries. This clearly needs to be the focus if we want affordable food.

The second distortion is the option to import certain types of produce in certain quantities to "cool down" rising prices. But this then hits farmers doubly. No, triply. They lose when crops fail because of the weather; they lose when the prices are low because of over-production; they lose when the prices are high because of imports. It's a wonder that they still stick to farming and sustaining our consumption.

Don't be fooled into thinking that other countries do not provide subsidy to farmers because of the provisions of the World Trade Organization. The name of the subsidy has changed — moved from the green box to amber or from direct to indirect — but not the reality. And don't be fooled into thinking that our farmers are paid huge subsidies. The bulk of the so-called agricultural subsidies go to fertiliser companies so that they produce and sell at cheap rates to farmers. The rest of the food subsidy, if we can call it that, is the purchase of food for distribution. So, there is an extremely unequal playing field out there. It needs to be understood. It is time we talked about the real cost of our food, about how to benefit the farmers who grow our food. This is not a business we can afford to lose.

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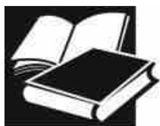
Understanding China's rise



BOOK REVIEW

JUDITH SHAPIRO

The Chinese superpower has arrived. Could America's failure to grasp this reality pull the United States and China into war? Here are two books that warn of that serious possibility. Howard W French's *Everything Under the Heavens: How the Past Helps Shape China's Push for Global Power* does so through a deep historical and cultural study of the meaning of China's rise from the point of view of the Chinese themselves. Graham Allison's *Destined for War: Can American and China Escape Thucydides's Trap?* makes his arguments through historical case studies that illuminate the pressure toward military confrontation when a rising power challenges a dominant one. Both books urge us to be ready for a radically different world order, one in which China presides over Asia, even as Chinese politicians tell a public story about "peaceful rise." The books argue persuasively that adjusting to this global power shift will require great skill on both sides if conflagration is to be avoided.

Mr French says in his exhaustively researched and fascinating account of geopolitics, China style, that the Chinese era is upon us. But, he asks, "How will the coming China-driven world look?" How best should its neighbours and its rival North American superpower respond?

Mr French, a former reporter for *The Washington Post* and *The New York Times*, argues that China's historical and cultural legacy governs its conduct of international relations, a legacy that sits uncomfortably with the Western notions of equality and noninterference among states. China's relations with its neighbours in Japan and Southeast Asia were for millennium governed by the concept of *tian xia*, which held that everything "under the heavens" belonged to the empire. A superior civilisation demanded deference and tribute from vassal neighbours and did not hesitate to use military force. China's testy relationship with Vietnam became fraught whenever a Vietnamese leader dared to demand equal footing with a Chinese emperor; the Japanese claim to divine origins was unacceptable.

When China lost its regional dominance at the hands of colonial powers and invading armies, it saw the situation as temporary. The struggle in the East China Sea over the Senkaku Islands claimed by Japan since 1895, for example, has long been a sore point in Sino-Japanese relations. But the reform-era strongman Deng Xiaoping advised China to "hide our capacities and bide our time" on this and many other issues. Hostility between China and Japan simmers in disputes over hierarchy, wartime apology and historical narrative, with the two "in a situation resembling galaxies locked in each other's gravitational fields, destined to collide repeatedly only to sail past each other after wreaking their damage." French shows convincingly that China's goal is now to displace the American barbarians and correct historic humiliations imposed by those who dethroned China from its rightful position at the centre of the world. China's recent spectacular land grab in the South China Sea is a *fait accompli*, given China's superior power in the area and its assertion that the region is a core national interest. Arbitrators for the United Nations Convention on the Law of the Sea issued a 500-plus-page decision against China and in favour of the Philippines in a dispute over the definitions of islands versus rock formations; they concluded that Chinese arguments had no legal basis. But as Mr French explains in sobering detail, China has unilaterally determined to claim much of the sea as its own. Similarly, China's projection of economic might through the new Asian Infrastructure Investment Bank and One Belt, One Road initiative, which intends to bind a huge swath of Asia to China economically via new land infrastructure and consolidated control of the seas, generates "a kind of fatalism or resignation about the futility of trying to defy it." Mr French's book was written before President Trump's repudiation of the Trans-Pacific Partnership trade agreement, but clearly the resulting power vacuum is nothing short of a gift to an empire bent on restoring its tributary realm.

Graham Allison's *Destined for War*, asks why, when a new superpower threatens to displace a ruling power, the clash of hubris and paranoia often (but not always) results in war. Mr Allison's examples include the Sparta-Athens conflict of the famous "Thucydides trap," when both sides laboured strenuously to avoid war but were seemingly driven to it by forces beyond their control, as well as Germany's challenge to the dominance of its neighbours at the start of the 20th century, which led to two world wars. Mr Allison's 16 cases also include four examples of power shifts in which war was avoided, as when Britain adjusted to the rise of the United States in the Great Rapprochement of the turn of the last century, choosing forbearance and eventually reaping great rewards through the countries' "special relationship."

Mr Allison, the director of Harvard Kennedy School's Belfer Center for Science and International Affairs, resurrects the Samuel Huntington thesis of a coming clash of civilisations to explain that China thinks in longer time frames and with a greater sense of hierarchy than the United States. In order to avoid the Thucydides trap, he writes, American policy makers must reject the tendency to think that China is like us and that it will respond as we would to identical provocations. Numerous situations could spark military conflict, from accidental collisions at sea to misunderstandings caused by cyberattacks to actions taken by third parties like North Korea or Taiwan.

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EVERYTHING UNDER THE HEAVENS
How the Past Helps Shape China's Push for Global Power
Howard W French
Alfred A Knopf; 330 pages; $27.95

DESTINED FOR WAR
Can America and China Escape Thucydides's Trap?
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Houghton Mifflin Harcourt Books
364 pages; $28