

BusinessLine

SATURDAY, JULY 15, 2017

Cut to grow

With inflation ruling well below the target band and industrial output turning tepid, the stage appears well set for a rate cut by RBI

The historically low inflation print of 1.54 per cent for June has strengthened voices arguing for a rate cut by the Reserve Bank, and understandably so. Inflation is at a level not seen since 1999, in the words of Chief Economic Advisor Arvind Subramanian. And it is not just about a fall in food and vegetable prices. Core inflation, that is non-food and non-fuel, at 4.03 per cent, is well under control too. Subramanian believes that “a paradigm shift in the inflationary process to low levels of inflation” is now under way. It means that the trend of low inflation prints in the last few months is an enduring one and therefore the Monetary Policy Committee (MPC) has to take that into its calculus while framing the interest rate policy.

At its last meeting in June, the MPC pointed out the many risks that could reverse the downward trend in inflation. The effect of the house rent allowance payments to government employees as per the 7th Pay Commission award, the possibility of fiscal slippages due to farm loan waivers by some States, the effect that GST will have on prices, and global uncertainties were offered as reasons for maintaining status quo on rates. To be sure, these factors continue to stay relevant even now. Yet, these should not be held up as reasons for not cutting rates as a rise from here on will still keep the overall inflation print within the MPC's band. Projections by SBI show that consumer price inflation will remain under 2 per cent in July and despite rising thereafter will average at 3.5 per cent for the current fiscal, with a downward bias. Most economists seem to believe that inflationary expectations have decisively changed in favour of a low price rise regime.

The industrial output data for May, with just a 1.7 per cent rise, clearly shows that the growth impulse in the economy is ebbing. Manufacturing growth decelerated to 1.2 per cent while capital goods output declined by 3.9 per cent, which is worrying indeed. Of course, some of this could be attributed to GST and the strategy of manufacturers to slow down output to push out stocks before the deadline. Yet, data since demonetisation would show that manufacturing has been consistently under pressure and desperately needs a leg up. The RBI has probably tied itself up with its shift to a neutral stance from an accommodative one in its policy review in February. Six months down the line, the conditions have changed and so have the data. It's time the central bank changes its stance once again and delivers what industry, government and markets have been clamouring for – a growth-stimulating rate cut.

Dilemma in resolving contractual disputes

Should contracts be enforced regardless of consequences or should public institutions consider the greater good?

ARUN MAIRA

The Supreme Court of India's verdict requiring two private power companies to comply with the contracts they had signed has stirred a large public debate. The companies say that circumstances beyond their control – changes in Indonesian laws – have made the price of their coal input too expensive for them to sell power to their Indian customers at the prices they had contracted. The companies pleaded for force majeure relief. Their opponents had feared that if their plea was accepted, it would be another instance of unforeseen losses of private companies being borne by society whereas the companies would have retained unforeseen gains if there were any. Their plea was that there must be sanctity of contracts to avoid such ‘moral hazards’. However, the other side's concern is that further investments will not be forthcoming unless a more practical view is taken even if it undoes a legal contract.

The moral hazards dilemma

India has made an ambitious push with PPPs (public-private projects) to build infrastructure for power, roads, airports, and ports. Many of these projects have become unviable because the requisites of their long-term contracts did not allow for unforeseen difficulties. These stranded projects have created a huge overhang of NPAs (non-performing assets) with Indian banks. Moral hazard is complicating the resolution of these NPAs, where, also, the principle of sanctity of contracts is colliding with the sustainability of economic growth. A more poignant issue where the sanctity of contracts is colliding with the sustainability of businesses is waivers of farm loans

by many state governments. With farmers unable to pay off their contracted loans, what is at stake here is the sustainability of farmers' lives. In this case, some of the same economists who plead for policy-makers and courts to be practical in the case of bank loans to large infrastructure companies, invoke moral hazard to argue against writing off the loans of small farmers.

Reality must be faced, whether one is from the left or right of the political spectrum. The future cannot be predicted too far. In the case of businesses, technological changes and geo-political uncertainties – especially when businesses become connected to global supply chains, as the Indian power projects were – make it very difficult to foresee all contingencies beforehand and factor them into contracts. Farmers have a very hard time too, predicting the weather and prices for their produce. In such cases, what should be honoured for justice to be done? The legal contracts that were signed – which in the case of the infrastructure projects – were clearly without coercion or, should considerations of the welfare of the farmers and investors, and the sustainability of their businesses and lives, over-ride legal contracts? What would make a better governed society? Enforcement of contracts, regardless of their consequences, as Shylock had insisted in Shakespeare's *Merchant of Venice*? Or, that public institutions should consider the welfare of all affected?

Citizens' trust in the ability of their state's institutions to deliver justice is a condition of good societies. In great societies, trust in institutions goes much deeper than expecting that legal contracts will be enforced regardless of their consequences. It comes from the confidence that, if something un-



Tight spot The principle of sanctity of contracts poses a problem for big business as well as farm loan waivers

desired happens, all points of view will be considered fairly and justice will be done.

The competence question

India's Supreme Court has been criticised by some people for its decisions in matters that it does not, according to them, have the competence for, such as the implementation of pollution standards for automobiles and the implications of power contracts. In these instances, the Supreme Court had not given any new decision. In the automobile industry case, it upheld a decision taken by the executive branch. In the power producers' case, it upheld the sanctity of contracts voluntarily entered into by the parties. Given the complexity of these issues, some economists have proposed adding an economist to India's Supreme Court.

But experts in no discipline, not even economists, can see all aspects of complex systems. Modern experts in social sciences, including economics, are becoming increasingly specialised. They know more than others do about a part of the whole, so do specialists in modern medicine. Therefore, one cannot expect to find any expert with a solu-

tion that will do justice to the welfare of the whole system. Besides, economists (and other experts) also have their ideological preferences. Those on the right of the political spectrum evoke the concept of moral hazard to deny farmers relief, while those on the left evoke it against forgiveness to large investors.

A comprehensive view

Many points of view, like the many blind men around the elephant, must be brought together to make sense of complexity. Moreover, in dynamically changing situations, conditions on the ground must be considered to understand reality. Therefore, good and just solutions can only come from a good process of participation of affected stakeholders.

A competent executive and unbiased courts are only two legs of the stool. The third leg is required for societal stability. The third leg is a systematic process of democratic deliberations to supplement the formal institutions.

Prof. Mark Moore of the Kennedy School of Government writes in *Creating Public Value: Strategic Management in Government*: “We might

think of this activity (of public deliberations) as helping to define rather than create public value. But this activity also creates value since it satisfies the desire of citizens for a well-ordered society in which fair, efficient, and accountable public institutions exist.”

In other words, the quality of the process of resolving economic and social issues and making public policy is a public good of great value in itself. It increases citizens' trust in the institutions that govern their lives. Moreover, participative and well conducted multi-stakeholder processes increase social solidarity, which makes good societies.

This is an investment more in need today than anything else. In great societies, trust in institutions goes much deeper than expecting that legal contracts will be enforced regardless of their consequences. It comes from the confidence that, if the unexpected should happen, all points of view will be considered fairly and justice will be done. Not doing so is a risk to the India story.

The writer is a former member of the Planning Commission (Through The Billion Press)

Why we need solid goods and services

Though we are creating IT-enabled intangible capital, we still need to think of people and goods who are not part of this shift

NOAH SMITH

In general, modern-day economists tend to ignore old schools of economic thought. The main reason is that economists before World War II typically used words instead of mathematics. Another reason is that old, radical ideas are often assumed to have been discredited.

For example, many economists now love to poke fun at the physiocrats. This was a group of French 18th-century economists who believed that only agriculture created national wealth. Their idea, coming on the eve of the Industrial Revolution, was spectacularly ill-timed. Today, with manufacturing and services accounting for the overwhelming majority of every advanced economy, it's clear that the physiocrats' thesis was incorrect.

Yet as technology and the global economy continue to evolve in strange and unanticipated ways, I think it's time to revisit the ideas of the physiocrats. Not the notion that agriculture is the only source of value – that's bonkers. But the basic idea that the measure of a country's

wealth should give special pride of place to certain types of goods and services deserves a re-examination.

In a digital world...

Information technology is doing some strange things to our economy. First, the economy is shifting toward intangibility. Physical capital – buildings, equipment and vehicles – matters much less to companies these days, while intangible capital matters more.

This trend has enriched the US and other countries, and promises to continue to do so. But there is a danger that in embracing the world of bits, governments will neglect the old, physical economy of atoms.

... why the physical matters

First of all, physical things are more essential to a baseline standard of living. While internet-based leisure activities may be more and more central to middle-class life, the poor still struggle to get things such as housing, heating and transportation. If governments let physical infrastructure such as buses and trains decay, the middle classes will still be able to surf the internet in



It takes all sorts Physical goods act as insurance in an IT-led world

peace, but poor people will struggle to work. Meanwhile, unless governments address the falling productivity of the home-building industry and take steps to provide cheap, plentiful energy to cities, it will be the lower socio-economic classes that suffer disproportionately. So if we care about alleviating the pain of poverty, we should think about the production of the physical goods the poor need most.

Second, physical goods act as a form of insurance. There's some chance that Russian, Chinese or

other hackers could make the internet unusable. Also, there's a remote possibility that ransomware, identity theft or other crimes could dramatically and suddenly raise the costs of doing business online. In either of those eventualities, countries that rely heavily on sales of digital services would be hurt much more than economies that produce more physical goods.

Third, the intangible economy may be running into the wall of urban political economy. Knowledge-based industries require a lot

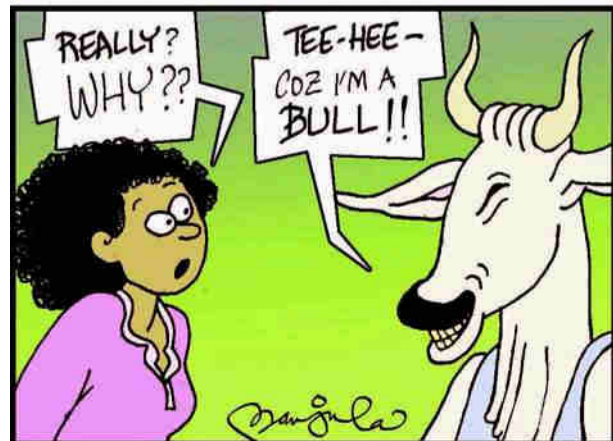
of smart people to be concentrated in cities. But because local homeowners tend to control local politics, they often oppose building enough housing to accommodate the increasing number of knowledge workers who need to cluster together. When this happens, it's usually the poor who get pushed out of town to the forgotten fringes of the local economy.

Fourth, physical goods are a lot easier to export. Though service exports have risen, most trade is still of the material variety.

Governments need to maintain roads, public transit systems, top-notch electrical infrastructure and a high-quality affordable housing stock. They should also consider incentives to keep manufacturing industries from disappearing. Those policies might not always be optimal from a pure value-added, economic efficiency standpoint, but they can pay off in ways not measured by gross domestic product. In this increasingly ephemeral age, we might need some physiocrats to keep us down to earth.

Bloomberg

SUKIYAKI MANJULA PADMANABHAN



LETTERS TO THE EDITOR

Send your letters by email to [bleditor@thehindu.co.in](mailto:bleditor@thehindu.co.in) or by post to 'Letters to the Editor', The Hindu Business Line, Kasturi Buildings, 859-860, Anna Salai, Chennai 600002.

**Air India's menu**  
This refers to “All for some chicken feed” (July 14). Air India (AI) is partly vegetarian, as it has stopped serving non-vegetarian food to passengers in the Economy class on its domestic flights citing unimpressive reasons. First, it is estimated that the discontinuing non-vegetarian foods would fetch AI a saving of ₹7-8 crore annually. The cost-cutting strategies may be justified in the sense that the boom in the aviation market dominated by a few airlines has weakened passengers' bargaining power.  
But in the long run, the competition in the aviation sector would be intensified once the alternate modes of domestic transport such as the Business Class train Tejas, connecting cities across the nation, are unveiled. Besides, high-speed bullet train would also be there to compete with airlines in the near future. “Cost-cutting

should not be at cost of customers” is a prudent business lesson that AI failed to learn. If AI is really cost-conscious, then it could save a lot by not allowing free domestic air-tickets for MPs  
**S Lakshminarayanan**  
Cuddalore  
**Sensex at 32,000**  
This refers to: “At 32K, Sensex feels frothy” (July 14). The investors in share markets have reason to cheer about the Sensex on Thursday as it surpassed the 32,000-mark for the first time, soaring more than 232 points, and the Nifty closed at a new peak of 9,832 as inflation hit a record low. However, the 30-share BSE index has taken 33 sessions to increase 1,000 points before it finally touched the significant 32,000-mark. The broader 50-issue NSE Nifty spurted 75.60 points to close at a fresh lifetime high of 9,891.70 bettering its earlier day trading.

Some traders ascribe this phenomenon to ample liquidity in the market. It looks like the 30,000-mark will remain a benchmark.  
**HP Murali**  
Bengaluru  
**Insulting AR Rahman**  
It was very sad that Hindi-speaking people streamed out of a concert by AR Rahman in London, betraying their language chauvinism. To add insult to injury, they demanded a refund of the cash they paid. The walk-out from the concert came as a surprise when the ‘Mozart of Madras’ sang more Hindi songs than Tamil songs. This indicated that they were more anti-Tamil than pro-Hindi and provided evidence of growing linguistic intolerance.  
In a multi-lingual society no one language can claim primacy or superiority over other languages. Non-Hindi speaking people are not naive to not understand that

Hindi imposition is an effective way of imposing a certain culture at the cost of their own cultures. While we do not undervalue any language, we pride ourselves on our language with its rich literature and expect the Hindi-speaking people to be proud of their language without trying to belittle other languages. A.R.Rahman spoke in Tamil when he received the Oscar award in Cannes. If numerical superiority is any reason to exalt a language to the status of the national language, by the same token, the crow should be our national bird.  
What would happen if non-Hindi speaking MPs walk out of Parliament when someone speaks in Hindi as the Hindi chauvinists did at the London concert? We must take care to stay away from doing anything that divides us on linguistic lines.  
**G David Milton**  
Maruthancode, Tamil Nadu

**Censorship and CBFC**  
Pahlaj Nihalani's appointment as the Censor Board chief has become a laughing stock.  
The Board has demanded the removal of terms such as “Hindu India”, “Gujarat” and “cow” from *The Argumentative Indian*, a documentary on Amartya Sen.  
The Board, set up to protect the public from the excesses of pot-boiler cinema, now presumes to cull the thoughts of one of India's foremost public intellectuals.  
It should be no surprise that Sen, one of the earliest critics of the government's alternative vision of India, should find himself at the receiving end of its ministrations.  
The Censor Board's contribution to the all-round effort to stifle thought has turned slightly comic.  
**J Akshobhya**  
Mysuru-570007