The pros and cons of rate cut

What is required is a change of growth strategy, from foreign finance-led to exports and domestic demand-driven growth

AJIT K GHOSE

Outside the Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI), there is growing clamour for a cut in the interest rate. The main arguments put forward by the proponents of rate cut are that the inflation rate is now low, that investment has been on the decline and needs to be revived, and that capacity utilisation in industry remains low. The MPC, on the other hand, argues that the core inflation and inflationary expectations are in fact still high. It also argues that a lower interest rate can neither revive investment nor increase capacity utilisation in a situation where companies are debt-laden and banks are burdened with non-performing assets. Other policies are required to deal with these problems.

What is puzzling in all this is that neither side in the debate mentions the policy "dilemma" that arises from the fact that India's economy is open to flows of international finance so that the interest rate and the exchange rate cannot both be controlled. A change in the interest rate has consequences for the exchange rate, which has effects on inflation, investment and growth.

I have deliberately avoided using the commonly used term "policy trilemma" because India's "import-oriented" growth strategy is, and has been for quite some time, premised on availability of foreign finance. During 2004/05-2015/16, the trade deficit was high, between three and seven per cent of GDP. Despite the cushion provided by the inflow of remittances (three-four per cent of GDP), the current account deficit remained between one and five per cent of GDP. The deficits were financed by inflows of foreign capital. In most years, the actual inflow was in excess of what was required to finance the current account deficit and the excess added to the country's foreign currency reserve.

Inflow of foreign finance depends both on monetary policies of the advanced countries, particularly of the US, and on monetary policies of the recipient developing countries. Until recently, the advanced countries maintained zero nominal interest rate and resorted to quantitative easing (money printing in simple language). So, financial flows to developing countries were large. But India's monetary policies were still relevant for attracting inflows; the interest rate in India determined whether the flows went to Brazil or came to India. Monetary policies of the advanced countries have now changed; quantitative easing is no longer in use and the nominal interest rate is being gradually raised. In this setting, the interest rate is of even greater importance in sustaining inflows of foreign finance.

This is where, I suspect, the real but unstated reason for the RBI's reluctance to reduce the interest rate lies. Even with unchanged interest rate, the inflow of foreign finance is most likely to decline. A reduction of the interest rate can only make the decline steeper, resulting in a serious depreciation of the rupee. Such developments would threaten to increase inflation, bring insolvency to companies that have borrowed in foreign currency, and usher in lower economic growth. The growth of services, linked significantly to capital inflows, would be directly squeezed and curtailment of merchandise imports would squeeze the growth of other sectors. The negative impact on manufacturing, which has become increasingly dependent on services incomes from the demand side and on imported inputs from the supply side, would be particularly strong.

The point is that the RBI is not in a position to use monetary policy to stimulate the economy fundamentally because the growth strategy being pursued requires foreign finance inflow to be maintained at a high level. Indeed, it is difficult to see how the RBI can even pursue its core mandate of maintaining the inflation rate between two and six per cent.

What is required is a change of growth strategy, a transition from foreign finance-led growth to growth driven by both exports and domestic demand. To achieve this, the focus of policies would have to be on achieving current account surplus and not on financing deficit. Growth of manufactured exports would require stimulation and import-dependence would need to be curbed. This will be helped by policies that encourage inflows of FDI (which are not sensitive to interest rates), particularly into manufacturing, while restricting non-FDI inflows (which are sensitive to interest rates). Growth of domestic demand can come from income growth in agriculture and rapid growth of agriculture would have to be a major component of the strategy.

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CHINESE WHISPERS

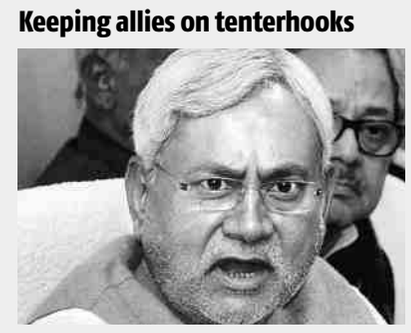
Advantage BJP

The Bharatiya Janata Party (BJP) has got a shot in the arm for its preparations for the Tripura assembly polls slated for March 2018. The party believes six Trinamool Congress legislators in Tripura are likely to vote for its presidential candidate Ram Nath Kovind (*pictured*). And this could pave the way for these legislators and others in Trinamool in the state to join the BJP in the run-up to the assembly polls. The state currently has a Left Front government led by Manik Sarkar. A Trinamool leader conceded his party had a tenuous hold over the legislators, and in some cases didn't even have their mobile phone numbers.

A nod to competitor

Pawan Goenka was excited when his company, M&M, prepared its first customer bill after the goods and services tax (GST) rollout. M&M's managing director shared the news on Twitter and billed it a "momentous occasion". In response, an official with rival Tata Motors threw a challenge: "As competitor we will do maximum number of GST billings by end of this financial year". Goenka offered his best wishes to the executive and added that he has "tremendous respect" for Tata Motors.

Keeping allies on tenterhooks



Janata Dal (United) boss and Bihar Chief Minister Nitish Kumar (*pictured*) kept his *mahagathbandhan* allies on tenterhooks all of Monday. While downplaying the differences within the Grand Alliance, he said he would continue to take decisions independently. While he saw no danger to the alliance at the moment, he said, "I can't say what will happen in the future." At a rally in Patna he came down heavily on Congress and Rashtriya Janata Dal (RJD), and said the Opposition should not object to all government moves just for the sake of it. All this came a day after JD-U General Secretary Shayam Razak told the media that JD-U would not attend RJD chief Lalu Prasad's "BJP hatao, desh bachao" rally in Patna on August 27 but the Chief Minister may do so in his personal capacity if invited by the RJD.

You're with us or against us

Beijing's zero-sum loyalty trap loses sight of the main prize — a profitable Hong Kong. Can the new chief executive make a difference?

VIJAY VERGHESE

Twenty years after the handover from Britain to China, the fate of Hong Kong continues to be measured by a yardstick that many would find risible were it not for the raw emotion it arouses and the hardening of polarised politics.

At the heart of this feckless debate is whether Hongkongers are pro- or anti-Beijing. This banal and irrelevant discussion has seemingly derailed sensible discourse on pressing issues like the usurious price of housing, education drift, caring for the elderly, health care, the dismal state of exports, and flagging private consumption.

The promise of the Year of the Fire Rooster appears elusive with the economy at an all-time low, barely pulling forward from the estimated 1.5 per cent GDP growth for 2016. It is time for Hong Kong to act. But where are its leaders?

A steady stream of bureaucrats schooled in the art of following orders by colonial masters has run the city since 1997, bereft of ideas. Bowing to Beijing has come naturally to some, a welcome relief perhaps. That Hong Kong is part of China and the mainland holds the key to the territory's growth is not in doubt. But the haste with which the city's bureaucrat-turned-politicians have aligned themselves with oftentimes inscrutable mainland thinking has had an unsettling effect.

Beijing faces a profound dilemma. It is a conservative parent with two offspring — one grudgingly obedient as long as the pocket money comes in; the other, recalcitrant, headstrong and averse to parental authority after an interlude of exploitative but strangely emancipating British tutelage.

It has two stark choices. Spare the rod and spoil Hong Kong, at the risk of losing the docile larger sibling too — in essence, an abdication of authoritarian Communist-led rule. Or the employment of quiet, even overt, intervention to bring a pint-sized city to heel.

The much experienced new Hong Kong Chief Executive Carrie Lam has a grand opportunity to change the course of Hong Kong's history. To do this, she needs to abandon the distraction of the "pro- vs. anti-Beijing" prism, and to view matters in a clear non-partisan manner. She needs a vision for Hong Kong. Leaders need to lead — not simply administer — and this faltering financial city has not seen enough of that.

The fact is that much of Hong Kong's so-called "independence" and pro-democracy activism so feared by Beijing and led by student groups like Demosistō is neither an independence movement (which would be patently unfeasible) nor some articulate political juggernaut. It is a clumsy and disjointed student awakening, only surfacing with the help of a more recent catalyst — former CE CY Leung's poor people skills and inability to read the local pulse.

LACKING VISION Much of Hong Kong's so-called 'independence' and pro-democracy activism so feared by Beijing and led by student groups is neither an independence movement nor some articulate political juggernaut REUTERS

This is not to say Hong Kong does not need civil awareness to try and involve people somehow in the "closed" political process, as the misguided Occupy movement attempted to do. But pro-democracy advocates and autonomy-seeking fringe groups have fallen straight into the "pro vs. anti-China" trap masterfully laid by Beijing. You are either with us or against us.

Recent official pronouncements from Beijing have reflected mounting concern and urgency, peppered with references to "love the motherland", "patriotism", "national tongue", and "national security law" (under Article 23 of the Basic Law to deal with "treason, secession, sedition").

For her part, an avowedly Beijing-friendly Carrie Lam needs to place the city within a China context but also make Hong Kong internationally relevant again with progressive laws, safeguarded freedoms, a robust free press, and quality education that welcomes debate and fosters both Putonghua and English. Most of all she needs a bold economic vision.

Putonghua remains a flashpoint. Europeans, South Americans and Indians often speak two to three languages fluently. Why should Hong Kong be any different? The city needs to learn that English and Putonghua are not Trojan horses with some dark imperialist intent. They are a practical imperative for survival and growth in a global economy.

Cantonese and its vibrant local culture must be preserved assiduously, not just as window dressing for cash-dispenser visitors, but for residents. Hong Kong is a Cantonese enclave. The city would do well to promote local art, creativity and small-scale industry, hard pressed by rising rents and the steady creep of an uninspiring mono-culture designer brand ethos.

For all its energy and bluster, Hong Kong has slowed discernibly and lost its way, in equal part due to residents' deep fear of Beijing (which puts many people in opposition to all suggestions emanating from China, good or bad), legitimate worries about a loss of identity (that has given rise to the localist movement), and a regressive desire for status quo. It is an odd pass for a city so favoured by pirates and adventurers who once chuckled at Singapore's schoolroom society.

Hong Kong has energy, vitality and that famous can-do risk-taking attitude. What it lacks is leadership. Vision.

The discussion needs to move away from whether pan-democrats, youngsters, academics or the government are with or against Beijing, to whether they are for a strong, progressive, open-minded Hong Kong that welcomes change. Clearly, much of what strengthens Hong Kong helps strengthen China. The two are indivisible.

If the city is to reinvent itself and compete on the world stage, its wealth measured not just in terms of money but in manners and mores and human capital, Carrie Lam — an able administrator, former chief secretary, would-be social worker and Cambridge scholar — must take a stab at this. There is too much at stake.

The author is editor, Asian Conversations

CONSUMER LIFE

Rural consumer sentiments fall in June

MAHESH VYAS

The BSE-CMIE-UMich Index of Consumer Sentiments declined sharply by 3.7 per cent in June.

Sentiments declined across urban and rural regions. Urban sentiments were down by a marginal 0.18 per cent. But, rural sentiments plunged 5.56 per cent.

This sharp fall in rural sentiments at the end of the first month on monsoons should be a source of worry.

A state-wise analysis reveals that sentiments declined in those states that received poor rains and they improved in those states that received good rains. Since the monsoon reaches north India only towards the end of June, we see the relationship between rains and rural sentiments only in the states south of the Vindhyas and in the eastern states.

Rural sentiments declined sharply by about 35 per cent in West Bengal and Kerala during June. Both states received less-than-normal rains during the month. Rains in West Bengal were 15-20 per cent lower than normal. In Kerala, it rained well in the last week of June, yet the cumulative rains during the month were 6.6 per cent below normal. Rural sentiments fell 21 per cent in Karnataka, 18 per cent in Chhattisgarh and 14 per cent in Madhya Pradesh. Rains were below par in all these states.

Maharashtra and Telangana received excellent rains and rural sentiments were up eight per cent and 19 per cent in these two states, respectively.

Jharkhand and Andhra Pradesh were outliers, though. In Jharkhand, rains were 37 per cent below normal but, rural sentiments were up by 53 per cent. In Andhra Pradesh, rains have been about 50 per cent above normal but rural sentiments were 14 per cent down.

Kharif sowings have started picking up. Foodgrain acreage was up by 9.5 per cent. Even *arhar* sowing has picked up although it is still 11 per cent lower than during the same period of the previous kharif season.

During January-April 2017, while rural India had the best consumer sentiments index, small towns had the worst

While sowings have picked up, rains have played truant. The first two weeks experienced 17 and 12 per cent higher precipitation than normal; but the next two weeks saw precipitation fall to 11 per cent and five per cent below normal. Overall, the monsoon was 0.14 per cent below normal till June 28.

Urban sentiments have been consistently lower than rural sentiments. In June, they were seven per cent lower than rural sentiments. Urban sentiments are also less volatile. Rural sentiments have been subjected to substantial external shocks in recent months, ranging from crashing prices and loan waivers. There is no matching external stimulus to spur urban sentiments. They have suffered a falling labour participation rate after demonetisation.

Urban sentiments have been poor across town-size. Interestingly, while rural sentiments have been quite buoyant, small towns have been very negative. This is evident from the region-wise distribution of consumer sentiments during January-April 2017. Urban sentiments are split into four town-size groups based on the number of households in 2011. Very large towns are those that had more than 200,000 households then; large towns are those that had between 60,000 and 200,000 households, medium-sized towns are those that had between 20,000 and 60,000 households and small towns had less than 20,000 households each.

Small towns are mostly census towns, or semi-urban towns. They have a population of more than 5,000 and at least 75 per cent of the working population is employed outside agriculture. These towns accounted for 30 per cent of the growth in urban population in the 2011 Census. Before their classification into census towns they were villages. So, in many ways these small towns are very similar to villages. But, their consumer sentiments are starkly different from their rural counterparts.

During January-April 2017, the all-India consumer sentiments index was 96.5. The index for rural India was 99.5. But, the index for small towns was much worse at 87.9. In fact, while rural India had the best index, small towns had the worst. One possible explanation for this is that the sops being given out to farmers in the villages do not accrue to these small towns. But, since their economies depend a lot upon the agro-economy around it, they suffer the ill-effects of demonetisation and the consequent fall in trade. The index for medium-sized towns was a shade better at 88.7, but only just.

Large towns were much better at 96.5. In fact, they were just at the all-India average level. But, the very large towns were a shade lower at 94.7.

The author is managing director and CEO, Centre for Monitoring Indian Economy P Ltd

LETTERS

Demonetisation gain

When the news item, "Cash is still king as circulation nears pre-demonetisation level: Report" (July 3) informs that 86 per cent of cash is back in the Indian economy, it is the time to bring down the curtains on the negative discussions about the fate of demonetisation. The continental size of the country, the poor banking infrastructure especially in rural areas, resistance of traders/unorganised sector to be above board in their transactions, illiteracy, abysmal poverty especially in rural/ tribal areas, and short learning time given to switch to mobile banking — short circuiting the debit cards usage stage — and not taking Opposition parties on board, all appear to have connived to defeat the government's sincere efforts to make India a cashless economy. Was the goal too high?

However, it is important to acknowledge that the demonetisation exercise has unleashed the forces — both on technological as well as strategic levels — which are constantly challenging the idea of need for huge cash in the economy and are focussing on deconstructing the pathways leading to the same generating new learnings in the process. It will be a double whammy if the regained high levels of cash in the economy discourage the central government from continuing its vigorous efforts in rightly curbing high cash usage. The government has correctly curtailed usage of cash in high-value transactions and must continue its efforts here.

What it may need is to make the entire issue bipartisan by creating a high-powered commission having multidisciplinary teams to make efforts to legitimately reduce cash in the economy. Inviting a political economy giant to head the commission will take the country forward in becoming a less cash economy in the medium term, which itself is no mean goal.

Y P Issar Karnal

Integration of military

With reference to "China 5; India 1" (July 1), a critical aspect of "upping our game" is the structure and capability of our higher defence organisation to manage a com-

plicated security environment. The appointment of a Chief of Defence Staff and integration of the military with the defence ministry was proposed post-Kargil, but it is yet to be implemented. Some ascribe the delay to politicians' and bureaucrats' fear of a coup. When General V K Singh was the army chief there was panic in the government when troops from Hissar moved for manoeuvres. Similarly, when small teams of army personnel were deployed on a logistics exercise around Kolkata, Mamata Banerjee saw a threat to her government. The integration of the military in the decision-making apparatus will allay these fears. The Indian military capability, though much improved, is constrained by poor infrastructure along the northern borders plus reported deficiencies in arms and equipment. The 5:1 ratio stands, but the "1" isn't insubstantial. It's time to up the game.

A K Ram Singh Indore

A historic reform

The Business Standard edition of July 3 carries several stories and articles on the goods and services (GST). The central theme differs from eulogising GST for its simplicity to calling it a terrorist law. The reader is informed of the never-tiring revenue secretary taking to Twitter to bust the "myths" about the new tax regime. In the Q&A the soft-spoken Central Board of Excise and Customs chairman answers the most worrying questions on GST. Some eminent columnists lament upon the lost opportunity by focussing on the critical inadequacies in the GST structure that have robbed it from acquiring the status of an ideal tax reform.

Be that as it may, there is no denying that GST, in whatever form it has emerged, is a historic reform. True, the structure does not match with the precedents across nations which have benefitted from GST or VAT. However, one has to remember that any reform, particularly one of such a huge dimension, is mainly a political exercise and not solely an economic thesis. It is inevitable that the design of any tax structure is influenced by the perception of the political masters of the day. Otherwise, does it look convincing that biscuits are taxed at 28 per cent and mobile phones at 12 per cent? Nevertheless, this is only the beginning. In due course, compelled experience of implementation and the need of much greater efficiency (and benefitting from the wisdom of critics!), the GST structure would acquire the expected lustre.

T R Rustagi New Delhi

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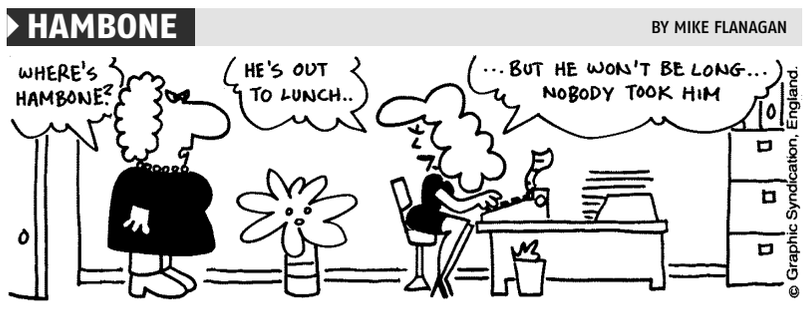
All letters must have a postal address and telephone number

HAMBONE

BY MIKE FLANAGAN



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Choose to negotiate

Dialogue with China more useful than raising the temperature

Recent skirmishes on the India-China border in the Sikkim region, leading to the cancellation of the Mansarovar Yatra pilgrimage through the Nathu La route, have underlined the need for a rethink on India's current approach to dealing with its north-eastern neighbour. The foreign policy and defence establishments, therefore, need to guard against the possibility of the country becoming a pawn in the larger contest between two superpowers, China and the United States. Muscular responses from the army chief about India's readiness to "fight a two-and-a-half front war" may play well to the domestic audience, but it ignores the urgent need for India to balance its interests with its capabilities. Few diplomats would have been unaware of the timing of the Chinese challenge. It occurred just as Prime Minister Narendra Modi concluded a $3-billion deal to buy US-made drones and a plan for trilateral naval exercises, including Japan, in the Bay of Bengal later this month. Some sort of Chinese riposte was thus inevitable.

China's reiterated refusal to support India's entry into the Nuclear Suppliers Group ahead of the Modi-Trump meeting and its continuing effort to block a United Nations resolution to label Lashkar-e-Taiba chief Hafiz Saeed a terrorist, even as the US ups the ante on cross-border terrorism, are clear signals of mounting concerns of India's US "tilt". New Delhi rightly regards a closer American embrace as serving Indian interests — a possible easing of rules for H1B visas and providing better access for pharmaceutical exports in return for easier market access for US firms. This friendship may also bolster the feel-good factor. Common sense, however, dictates that this relationship, however desirable, needs to be balanced by an understanding of the rising challenger over the Himalaya, with whom India shares a 3,500-km long border, disputes over which involve endless arguments over opaque and contested historical facts.

Equally significant, the world's second-largest economy is five times larger than India and has military capabilities that are manifestly superior. In the past, both countries pragmatically separated border issues in the interests of deepening the strategic direction. Despite a conspicuous personal outreach by Mr Modi at the start of his term, relations can scarcely be considered to be on an even keel. India's decision not to participate in the One Belt One Road initiative may be rooted in sensible economics — principally that it demands the use of Chinese credit and equipment — but to stay away from the initiative altogether was surely unwise, as is the decision to put China at a disadvantage in India's domestic market.

The tough talk on Sikkim may partly reflect a realisation of India's narrowing options in the face of China's economic and military superiority and its expanding presence in the oceans, islands and mountains around India. Put baldly, India has nothing to gain from even a limited confrontation with China and it urgently needs to lower the temperature on Nathu La. A distant friend may help, even though it involves an unpredictable leader. But nothing will be lost if India were to engage with China in a dialogue.

Slow and unsteady

Lax execution of a new realty law is hurting the sector

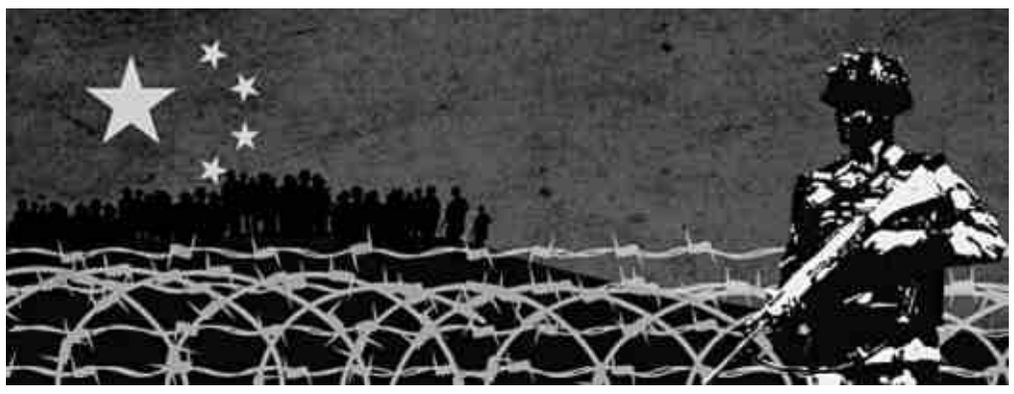
On May 1, a new piece of legislation governing the real estate sector came into force. The Real Estate (Regulation and Development) Act, 2016, was drafted and passed amid great expectations; it was hoped that it would tilt the balance of power in the sector back towards purchasers of homes, and aid in the government's efforts to clean up the sector. This might still happen. However, more than two months after the passage of the law, there are concerns that its slow and faulty implementation may cause a sustained slowdown in the construction and housing sector. The law is supposed to be fully implemented by August 1, but it is far from clear whether it will be — and, if not, what the implications will be for the real estate sector.

While RERA is a central law, its implementation requires the co-operation of state governments. The law requires each state and Union Territory to set up its own real estate regulatory authority. It will be this authority that should frame the rules under which the Act will operate in that state or Union Territory. Further, all the projects and agents operating in the state are supposed to register with this state-level regulatory authority within three months of the notification of the Act. This provides important transparency to buyers, as they can then check the details of a supposed project's actual regulatory filings for themselves on the regulators' websites.

However, not all states have been playing ball. Several have waited too long to release the final rules. Naturally, many projects and agents have waited as well, leading to a slow pace of registration. Nor is the law particularly well drafted. It is not a surprise that a constant drip of clarifications and changes has caused many project owners to wait and ensure that they comply with the final and updated version of the rules before registering. As of last week, therefore, only three projects were reported as having been registered in Rajasthan. In Mumbai, although there may be as many as 800 real estate projects under way in the city proper, not one had sought registration as late as last week, according to a newspaper report.

Many state governments are lagging in the full and proper implantation of the Act. As of last week, 24 of 36 states and Union Territories had not set up regulatory authorities and 16 had, reportedly, failed to notify their rules. Almost none of the states had begun to work on a website — although the Act requires the details of all registered projects and agents to be made available on such a site. In fact, many states seem to be unprepared even for manual registration. In other words, few states seem to be prepared to meet the August 1 deadline. Some major disruption of business seems inevitable for the sector. This is doubly unfortunate, given that this sector was particularly hard hit by demonetisation. The GST has, of course, introduced a new taxation regime. Consumers may continue to suffer as long as the sector is unstable and the transparency promised by the Act is not fully realised.

ILLUSTRATION BY AJAY MOHANTY



The Sikkim patrol clash

India's new assertiveness on China border nudges Beijing towards a settlement but managing each patrol confrontation remains tricky

BROADSWORD

AJAI SHUKLA

The territorial and boundary dispute between India and China is a complex, historical, multi-layered wrangle across a sprawling 3,500 kilometre-long border. Yet, a relatively simple disagreement has brought patrols from both armies eyeball-to-eyeball on the Sikkim-Tibet border since June 16 and led to China blocking the travel of Indian pilgrims to Kailash Mansarovar through the Nathu La border pass. At issue is sovereignty over a scenic, 4,000-metre-high pasture called Doklam — less than 100 square kilometres in spread. India claims that the Chumbi Valley, a dagger-shaped wedge of Chinese territory protruding southward from the Tibetan plateau, ends north of Doklam at the Batang La pass. China asserts ownership of Doklam, too, claiming the boundary runs south of the pasture, along the dominating Gyemo Chen mountain, which China calls Mount Gipmochi. Complicating this otherwise straightforward dispute is Bhutan, since the tri-junction of the Sikkim-Tibet-Bhutan boundary falls here. Bhutan's claims are supportive of India's.

Except for Ladakh, which lies northeast of the Himalayas, the *de facto* Sino-Indian boundary, called the Line of Actual Control (LAC), broadly follows the Himalayan watershed. The commonest form of dispute — and there are 14 separate disputes along the LAC — is whether one ridgeline, or the neighbouring one, constitutes the watershed. The 1962 war was sparked off near Ziminthang by disagreement over whether the boundary ran along the Thagla Ridge, as India claimed, or along the Hathungla ridgeline to its south, as China contended. The 1986 Sumdorong Chu confrontation, which saw India moving tens of thousands of troops to the trouble spot, was over the tiny Thangdrong grazing ground near Tawang, with India claiming the watershed ran north of that meadow, and China claiming it was to the south. At Walong, too, at the eastern end of the Sino-Indian boundary, disagreement centres on which ridgeline constitutes the watershed. These small disputes over the alignment of the LAC are sub-sets of a major overarching territorial dispute — in which China claims all of Arunachal Pradesh (Southern Tibet); and India claims the Aksai Chin plateau.

Many of the 14 sub-disputes on the LAC are over relatively inconsequential grazing grounds and meadows. However, the on-going standoff at tri-junction, at the southern tip of the Chumbi Valley, is over territory that both Beijing and New Delhi regard as strategically important. Indian military planners worry that letting Beijing extend the boundary southwards to Mount Gipmochi would bring China closer to the Siliguri corridor — a narrow sliver of Indian territory between Nepal and Bangladesh — which connects India's seven northeastern states with the Indo-Gangetic plain. In fact, advancing to the Siliguri corridor would require Chinese troops to break through strong Indian defences in Sikkim and advance southwards more than a 100 kilometres through difficult jungle terrain — a tough military task. The beleaguered Chinese units that do make it to Siliguri would have to beat back inevitable Indian counter attacks. Even assuming that China obtained control over the Siliguri corridor, India could simply bypass the corridor, moving through Nepal or Bangladesh.

If India's sense of vulnerability over Siliguri is overblown, Beijing's wish to extend the Chumbi Valley southwards is incomprehensible. Of all China's border vulnerabilities, the Chumbi Valley is perhaps the greatest. It is a narrow salient overlooked by Indian defences, which can cut off the valley from Tibet by wheeling east from north Sikkim, capturing it at leisure. Strategists regard the capture of the Chumbi Valley as an obvious wartime target for India's "mountain strike corps", when it is operational. By extending the Chumbi Valley southwards, therefore, China would only be expanding a key vulnerability.

Why then is Beijing pressing its case for the Doklam Plateau so determinedly? The answer is probably that, unlike many claims elsewhere, Beijing has an arguable case here. As China's foreign ministry spokesperson spelt out in tedious detail last week, the 1890 Anglo-Chinese Convention Relating to Sikkim and Tibet specifically mentioned Mount Gipmochi as tri-junction of China, India and Bhutan. True, Beijing rejects as "colonial impositions" other British era agreements, like the 1914 Simla Convention that birthed the McMahon Line. But, there is a difference — China actually signed the 1890 agreement, and not the 1914 one. Beijing also argues that Jawaharlal Nehru endorsed the 1890 agreement in a 1959 letter to Zhou Enlai.

Beijing also cites a pastureland claim over Doklam, arguing that the yak graziers of Yadong have long held grazing rights over Doklam, and that graziers from Bhutan paid a "grass tax" to Yadong graziers if they wanted to herd there. China's foreign ministry claims the Tibet Archives still possess "grass tax" receipts from earlier times. The grazier argument is a powerful one in borderlands peopled by nomadic herders. Both China and India use it to back their territorial claims in other disputed sectors.

Although Beijing has made Indian withdrawal a precondition for de-escalating the Doklam face-off, Indian forces are showing no sign of blinking. This firmness follows a pattern seen in earlier patrol confrontations in Ladakh, like in Daulet Beg Oldi in April-May 2013; and in Chumar in September 2014. Over the preceding decade, India's defensive posture has been greatly stiffened by raising two new divisions in the Northeast; an armoured brigade each for Ladakh and the Northeast; a mountain strike corps currently being raised and major improvements in India's air defence and air strike capabilities. Whereas once, China bullied India on the LAC and — as it is attempting in Doklam — built roads, tracks and bunkers as "facts on the ground" to consolidate its position in any future negotiation; today the Indian Army is rightly willing to, and capable of, physically blocking such attempts.

The question then is: Does the army's new assertiveness risk a patrol clash escalating into shooting and possibly skirmishes on a wider front? There has been no shooting on the LAC since 1975, a peace bolstered by the successful "Peace and Tranquillity Agreement" that New Delhi and Beijing signed in 1993. China has pressed for additional agreements, most recently a "Working Mechanism for Consultation and Coordination" in January 2012; and a "Border Defence Cooperation Agreement" in October 2013. Yet, inexplicably, Beijing continues to resist Indian calls to formalise the LAC's alignment — an important first step towards resolving the larger territorial dispute. A clear LAC alignment, recognised by both sides, would end the imperative to "create facts on the ground". This would also greatly reduce patrol clashes — and tamp down the nationalism sentiment in stands in both countries in the way of a comprehensive settlement. Paradoxically, India's pro-active LAC stance is creating incentives in Beijing for an LAC settlement. Yet, calibrating the aggression and managing each patrol confrontation remain tricky balancing acts. Until an LAC agreement comes about, New Delhi must develop the instruments and expertise needed for managing such crises.

Farm loan waivers not easy to implement

TESSELLATUM

NEELKANTH MISHRA

The clamour for farm loan waivers does not seem to be abating, even if it has been pushed to the back pages for now by news around the goods and services tax transition. We continue to believe this is a structural issue, with rising agricultural productivity (helped by roads, phones and electricity) pushing up supply, whereas food demand growth has weakened due to falling per capita calorie demand and slowing population growth. Food processing and exports can help release some pressure, but these may take time to grow.

While political forces may have precipitated the issue around loan waivers, the stress was very clearly visible: Agricultural income growth slowed sharply in the last three years after nearly a decade of double-digit increases. Even the sense of optimism that a good monsoon used to bring has been tempered, as last year's weak pricing offset stronger volumes. This year, with the monsoon running six per cent above normal and deficient only in the eastern part of the country, area sown under kharif crops so far is up 19 per cent over the same time last year. These are early days as only a fifth of the area has been sown in June, and year-on-year comparisons thus far may also be helped by a lower base (last year the monsoon had started late). However, it does appear that weak pricing may not affect acreage sown.

A normal monsoon this year may again worsen the oversupply, underscoring the structural issues facing agriculture. States with elections due in the next year or so may be the most vulnerable to such demands. It is pointless and a trifle late to pontificate on the advisability of loan waivers now: Analysing their implications may be more useful.

The trouble with farm loan waivers is that they are relatively easy to announce, but rather more difficult to implement. The challenge is not primarily fiscal (i.e. finding the funds): While the basic contours of these waivers have been publicised in some states these need to be translated to individual details before banks can waive loans. This means answering several non-trivial questions: Should there be crop-specific waivers, should those with irrigated farms get less, should absentee landlords get nothing, and by corollary should tenant farmers get more? What should be the quantum of waiver, and how should this be phased out? We understand that loans data are not linked to specific crops, tenancy records are patchy, and irrigation data are not updated. It is likely to take state governments many months to identify beneficiaries and execute on the plan, by which time the numbers may be very different. In the 2008 loan waiver for example, the announcement was made in February, the Cabinet approved it in May, the first disbursement happened in December that year, and the exercise was completed only two-and-a- half years later. Also, the final amount waived was 27 per cent, or ₹19,000 crore lower than first announced.

This delay makes matters worse during the period of implementation. As farmers are not clear how much of whose loans are going to be written down, their repayment behaviour gets affected, and banks then curtail lending to these regions. Indeed, in the months of April and May this year, year-on-year growth in agricultural loans for Scheduled Commercial Banks (SCBs) fell sharply to just 1 per cent and 7 per cent, respectively, the lowest levels in a decade. Telangana and Andhra Pradesh also saw a sharp dip in loan growth when they started their loan waivers three years back. Even priority sector lending (PSL) targets may not help as these are set on the previous year's closing loan book, and system loan growth last year was merely 5 per cent. A slower influx of fresh funds into these economies then slows down overall activity as well, contrary to expectations of a consumption boost.

We estimate that the total agricultural loans outstanding are about ₹15 lakh crore (including loans from SCBs, rural cooperative banks and Regional Rural Banks), of which a bit less than ₹10 lakh crore is in the nine states where waivers have been announced, or are part of the political discourse already. If every affected state were to waive loans in the same ratio as UP and Maharashtra did (about 30-31 per cent of SCB loans outstanding), about ₹2.1 lakh crore would be waived. However, the waivers announced in Punjab and Karnataka are much smaller: 16 per cent and 9 per cent, respectively. This suggests that the aggregate waiver would be in the range of ₹1.2 lakh crore to 1.5 lakh crore.

The complexity of implementation as well as the lack of fiscal space may force state governments to spread these waivers out over several years. Telangana, Andhra Pradesh and Tamil Nadu have already been doing so, and Punjab has made a similar announcement. Moreover, for many of the states considered in the analysis waivers may be announced much later. If these waivers were to be spread over four to five years, the annual impact would be ₹30,000-35,000 crore: Not a trivial sum, but at about 0.2 per cent of GDP, a manageable number for the bond markets.

The writer is India Equity Strategist for Credit Suisse

Decoding the pollution control debate

BOOK REVIEW

AJIT BALAKRISHNAN

I must confess when I hear impassioned debates about environmental issues I am tempted to wonder what the hot air being expelled is all about: Isn't it obvious that businesses (and other enterprises) must go about their work responsibly and make sure that the effluents they create in their manufacturing processes be suitably treated such that they don't pollute the environment? How can our business tycoons be so cavalier about such commonly shared things like the water we all drink or the air that we all breathe?

My bewilderment rose to new heights when President Donald Trump declared last month that the United States will exit the 2015 Paris Agreement to limit environmental pollution that leads to an increase in the earth's temperature. What could possibly cause the US, a country that is generally at the forefront of progressive international initiatives, to exit a pact that has already been signed by 195 countries? Is there more to environmental issues than what I had gathered from my casual reading of newspapers and other media?

This bewilderment is what drove me to cram Runa Sarkar's book, *Businesses, Institutions, and the Environment*, along with the heap of books that I put into my bag last week when I got to take a few days off from work and go the Masai Mara in Kenya. It helped that at a slim 140 pages it is easy to travel with this book (it is part of Oxford University Press' "Short Introductions" series).

If a measure of the worth of a book is a list of things a reader gets to know after reading it as compared to what he knew before he read it, then, Professor Sarkar's book is worth a lot to me. For instance, I had not known that the arrival of the smartphone, that constant companion to all of us nowadays, has led to a dramatic reduction in the large number of other devices that have littered the landscape so far: Watches, alarm clocks, weather gauges, calculators, radios, and so on. Or that the invention of sharing models like Ola and Uber in transport and Airbnb in travel has made transportation and travel less taxing on the environment.

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This book also reminded me that we in India woke up to the challenges of industrial pollution that dark night on December 2, 1984, when deadly methyl isocyanate gas leaked from Union Carbide's Bhopal plant killing more than 10,000 people and injuring several thousand other poor people living near the factory. It is only after this terrible event that the authorities launched a massive regulatory effort to update the ancient (1948) Factories Act that was supposed to govern the working of factories but also spent time and effort to create other related legislation.

Professor Sarkar also walks us through the Serengeti of the environmental protection world: The command and control institutions (Pollution Control Boards are an example), market-based measures (fines, penalties, tradeable emission permits), global institutions (WTO-like outfits) and NGOs (Sunderlal Bahuguna and his Chipko movement, Medha Patkar's campaign against large dams are examples). The book also has a number of case studies about Indian firms both big and small who are tackling environmental issues successfully.

It surprised me to discover from this book that the main culprits in creating pollution in the world and more so in India are not large Union Carbide Bhopal-style factories with smoke belching from chimneys. The real polluters apparently are medium and small enterprises. Such small enterprises, according to scholarly studies account for 70 per cent of the pollution in the world. It turns out that such enterprises pollute more per unit of output compared to large-scale enterprises because of inefficiencies in their production processes, inferior equipment or their location, which is often in or close to residential areas.

This, I suddenly realised, is what makes pollution control such a double-edged sword: These 46 million small enterprises that are at the forefront of causing pollution in India are the very institutions that are the sources of livelihood for 106 million of our fellow citizens, account for 45 per cent of India's industrial output and 40 per cent of exports. Coming down hard on this sector would jeopardise the whole economy. I guess therein lies the dilemma about control of environmental pollution.

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