The awkward case for expensive power

Is solar energy becoming a Veblen good for India?

VANDANA GOMBAR

Imagine a "Sale: 90 per cent off" sign in a shop, and no one turns up. There are goods for which a fall in price actually leads to a fall in demand, and there is a term for them — Veblen goods. Most of these would be luxury retail goods, where the higher price is part of the appeal of the product. Think Birkin bags.

When solar power was offered at ₹15 per unit back in 2009-10, India was setting up new plants, and it continued to add capacity and increase targets, as prices declined. When solar power price dipped to a low of ₹2.4 per unit in the last auction in May, one would have assumed that there would be a spurt in activity, now that solar was unequivocally cheaper than coal power. Instead, there seems to be a surprising rethink on solar capacity additions within the government. Is solar becoming a Veblen good for India?

Like all countries, India should want to move towards a market where power is competitively priced, reliable and clean. Except that perhaps it does not. The country's chief economic advisor, Arvind Subramanian, made a rather bizarre statement recently, "Our provisional assessment is that for India, and for some time, the social costs of renewables are likely to exceed those of thermal."

THE WORLD BANK'S DOING BUSINESS RATINGS

	2016	2017
Overall rank	131	130
Getting Electricity	51	26
Getting Clean Electricity	?	?

Source: *doingbusiness.org*

With the negative externalities associated with coal, this assessment is intriguing.

Subramanian's explanation is: The "social cost of renewables should include the cost of stranding thermal power and coal assets", as well as the cost of installing storage, among other things.

There is a lot to disagree over in this. In that disagreement could be lost the momentum that solar power had gained in the country. Solar power capacity has crossed 13 gigawatts, but it is a long way away from the targeted 100 gigawatts by 2022. Wind is a little over halfway to the target, at almost 33 gigawatts. Projects are facing payment delays, output curtailment and renegotiation or cancellation of power purchase agreements — all red flags for prospective investors.

Corporate India, meanwhile, is trying to consume cleaner power while keeping its bills in check. One way to do that is to buy power directly from clean energy generators. Delhi Metro, for example, signed an agreement to buy power from the Madhya Pradesh government-promoted 750-megawatt Rewa solar project. The decision to levy an interstate transmission charge has shaved off 35 per cent of the savings of ₹1,220 crore that the Delhi Metro was expecting from the solar procurement over a 25-year contract period, *Business Standard* reported last week.

In the World Bank's Ease of Doing Business Report, India has significantly improved its rank under the "Getting Electricity" head. If the report was instead measuring "Getting Clean Electricity" — which is what it should also look at since global companies are under pressure to show how renewables-friendly they are — India would be demoted.

Companies that are committed to getting 100 per cent of their power from renewables would likely think twice about expanding in a country where securing green power is a challenge. There are 102 companies that have signed on with RE100, a group promoting this target on green electricity, and they include familiar names such as Apple, Facebook, Google, Infosys, Microsoft, Ikea, Adobe and Swiss Re.

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CHINESE WHISPERS

Change is the only constant

Media personnel frequenting Udyog Bhawan, which houses the commerce, heavy industries, MSME, textiles and steel ministries, were caught off guard on Tuesday after finding that a waiting room used by them had been converted overnight into an office space. Sunday's Cabinet reshuffle had led to a flurry of activity. While new ministers have been shifting into their new offices along with their army of secretaries and advisors, they have also been moving furniture about, adding new carpets, curtains and nameplates. Among the more subtle reminders of life's ever-changing nature was the sight of a visitor nearly tripping over framed photos of an outgoing minister placed unceremoniously against a wall in the corridor.

Strange bedfellows

Bihar Chief Minister Nitish Kumar is said to be miffed with the Bharatiya Janata Party (BJP). Kumar leads the Janata Dal-United (JD-U), which was ignored in Sunday's reshuffle of Narendra Modi's Council of Ministers. Not one to sit quiet, Kumar reached out to BJP allies in Bihar such as Lok Janshakti Party (LJP) chief Ram Vilas Paswan and Jitan Ram Manjhi of the Hindustani Awam Morcha (Secular). Kumar and Manjhi had split on a bitter note, but politics turns foes into friends rather quickly. Paswan met Kumar after the JD-U formed an alliance with the BJP-led National Democratic Alliance. The LJP chief was taken aback when Kumar offered to accommodate Paswan's brother, Pashupati Kumar Paras, in his state Cabinet. When Paswan pointed out that Paras was not a legislator, Kumar is believed to have told him that he would ensure Paras got elected to the state Legislative Council. Kumar is said to have told Manjhi that he would make his son a minister.

Sign of things to come?

The Congress in Bihar is worried that more than two dozen of its 27 legislators might break away to join Chief Minister Nitish Kumar. Sources in these parties said that Kumar, Lok Janshakti Party chief Ram Vilas Paswan, Hindustani Awam Morcha (Secular)'s Jitan Ram Manjhi and some other small players in Bihar are concerned that an all-powerful BJP was unlikely to pay much heed to them, and that they should start preparing for an early election to the state Assembly, otherwise slated for 2020. The induction of Ashwini Kumar Choubey, a rival of Bihar Deputy CM Sushil Modi, into the Union Cabinet is also being seen in the Kumar camp as a sign of things to come. Kumar and Sushil Modi are friends.

Pension as mandatory savings

Before tinkering with the basic framework and philosophy of the NPS, it is useful to understand what low pension coverage means

RENUKA SANE

The Reserve Bank of India committee on household finance (Ramadorai Committee) has commented on the low pension participation of Indian households. This is something that several committees constituted by the Pension Fund Regulatory and Development Authority (PFRDA) have also worried about. The Ramadorai Committee as well as the PFRDA committees have suggested increasing the incentives of distributors (and fund managers) to incentivise people to join the National Pension System (NPS). But before we tinker with the basic framework and philosophy behind the NPS, it is useful to agree on what low pension coverage means and the place of the NPS in such a framework.

Across the world, pension participation typically means coverage in plans that are either mandatory or universally provided by the state through tax revenues. Voluntary coverage incentivised through tax breaks is in addition to these universal or mandatory programmes. In India we have three main kinds of pension schemes. The first is the NPS, which is mandatory for civil servants. The second is the Employees' Provident Fund Organisation (EPFO), mandatory for employees in firms of 20 or more people. The third is the Indira Gandhi National Old Age Pension Scheme (IGNOAPS), a pension given to the destitute elderly. When we say low pension coverage, we usually mean that a large number of citizens do not have access to any of these programmes and are left to themselves to find ways to finance consumption in old age.

Savings, on the other hand, are voluntary and can be influenced by various factors such as risk aversion, lifecycle needs, access to products and financial literacy. Just because an individual does not have a pension account does not necessarily mean that she has no savings to finance consumption in old age. In fact, as we are talking about voluntary savings, the first-order question is whether people save enough and not whether they save through plans called pensions.

It is in this context of voluntary savings versus mandatory programmes that the pension debate in India needs to be placed. When we say we want to increase pension participation, do we want to increase participation through the mandating savings route? Or do we want to incentivise people to save into specific pension products? We have limited evidence on the question of whether households in India end up with too few resources in old age and how they finance their consumption as a consequence. International evidence shows that households are myopic; this has motivated the setting up of mandatory pension programmes.

The really poor households in India are unlikely to have any savings and would require state support in the form of cash transfers. The Ramadorai Committee report shows that households that have savings over-invest in physical assets, in general. Households rely — perhaps over-rely — on children for old-age support. Thus, low financial savings and suboptimal investments suggest a case for mandatory savings in the NPS. However, this can be difficult to enforce and in a large informal sector such as India may not be possible to do immediately.

PENNY WISE **On the subject of voluntary savings, the question is whether people save enough and not whether they save through plans called pension**

This brings us to the question of voluntary savings. It is tempting to go in the direction of increasing distribution charges to lure more people into the NPS on a voluntary basis. High incentives in other products have not given us very high participation — in some products such as insurance, they have certainly given us very low persistence. Consumer protection problems are pervasive in retail finance, as the Ramadorai Committee report also notes. By increasing the fees on the NPS we are making it more like a mutual fund; it is not clear why we should head in this direction, when a mutual fund industry already exists. Allowing NPS fund managers to market the NPS also opens the floodgates for increasing charges and diluting it for existing customers, most of whom are there as a result of the mandatory civil services reform.

Ultimately, the way to a higher pension coverage is to find ways to mandate pension participation and simultaneously have state subsidies in the form of cash transfers for the really poor. This requires action on three fronts. First, we need to improve programmes such as the IGNOAPS. Only when this happens will the destitute elderly have access to a pension. Second, we need to consider ways to mandate the NPS, perhaps with a much lower contribution rate than 20 per cent to firms with less than 20 employees and to the self-employed. Across the world, this has been the path to pension coverage; it should be no different in India.

Third, we need to improve the existing schemes and arrangements. For example, we need to facilitate giving existing EPFO employees a choice between the Employees' Provident Fund (EPF) and the NPS. We also need to deal with the funding issues of the Employees' Pension Scheme (EPS). We need to improve the draw-down phase of the NPS so that people are able to translate the accumulations into a steady flow of monthly pension income. Questions of tax parity between the various schemes need to be resolved so that one is not unfairly penalised.

The OASIS Committee Report commissioned by the Ministry of Social Justice and Empowerment in 1998, that was the genesis of the NPS, had anticipated consumer protection issues seen in other retail financial products. The NPS design of separating fund management and record-keeping of an auction-based mechanism for discovering fund management fees and passive management frontally addresses these concerns. It is crucial to continue with this, as a good low-cost product is a prerequisite if we are to coerce citizens to save for old age.

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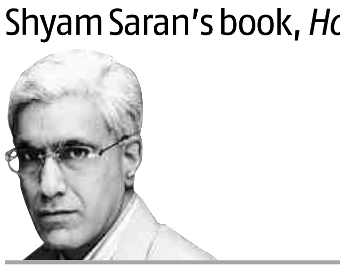
AS I SEE IT

When history failed to turn

Shyam Saran's book, *How India Sees the World*, identifies two 'missed moments'



KARAN THAPAR

In school we're taught about the turning points of history but there are occasions when, because of human antipathy, intransigence or folly, history fails to turn and an opportunity to resolve a problem is lost. These are stories that rarely get told. However, Shyam Saran's new book, *How India Sees the World*, identifies two such missed moments.

The first is to do with Siachen and Sir Creek in 2006. Saran was foreign secretary at the time. He had worked out with his Pakistani counterpart, Riaz Mohammed Khan, a Siachen deal similar to the 1992 understanding, which did not fructify. This time, unlike earlier, Pakistan agreed that the annexure, which demarcates the positions the two countries would retreat from, "had the same legal validity as the agreement itself". Saran says this made it "politically sustainable".

However, M K Narayanan, then national security advisor, "launched… a bitter offensive… saying that Pakistan could not be trusted, that there would be political and public opposition… and that India's military position… would be compromised". Gen J J Singh, the Army chief, who, till then, was in favour of the deal, now switched sides. Thereafter, home minister Shivraj Patil and defence minister Pranab Mukherjee decided "to play it safe and proposed deferment… of the proposal until further study".

Indian soldiers at Siachen Glacier base camp REUTERS

As Saran writes: "My defence of the deal became a voice in the wilderness. The Prime Minister chose to keep silent and not step into the fray." Consequently "the opportunity to finally resolve a long-standing issue and a constant source of bitterness in Pakistan was lost."

Thus was an opportunity to resolve Siachen squandered. As a result, a second agreement, this time on Sir Creek, also fell apart. To quote Saran: "Pakistan was no longer interested in a standalone Sir Creek agreement."

Whether it was lack of political courage or the antipathy between Saran and Narayanan — echoes of which are clearly audible in this book — is a matter of detail. The tragic truth, as Saran puts it, is that "these two agreements would have been in our interest".

Much the same, it seems, happened with the Indo-China border dispute in 1959. However, in this case, one needs to start by appreciating the background revealed by Saran.

First, India's claim to Aksai Chin, writes Saran, is weak and tenuous. The Survey of India maps inherited from the British show much of this area as "undefined". It was only in 1954 that new Indian maps asserted the country's cartographic claim but, as Saran argues, "this may not have been a wise decision because it deprived the Indian side of flexibility in negotiating a compromise with the Chinese."

Second, quoting Nehru, Saran says in 1957, Zhou Enlai, then Chinese prime minister, "made it clear that he accepted the McMahon Line, chiefly because of his desire to settle outstanding matters with a friendly country". Thus emerged an opportunity to trade off India's uncertain claim on Aksai Chin in return for complete acceptance of the McMahon Line.

In 1984, when Saran was serving in China, this was proposed by the Chinese with the additional offer of 3,000 sq km in the west, a significant improvement on Deng Xiaoping's earlier "package proposal". In Saran's words, this was "the best deal we could hope to get". All that was required was for Indira Gandhi to visit Beijing to conclude matters.

Unfortunately, G Parthasarathy, then a key advisor to the prime minister, "was not convinced". His hostility to China was the stumbling block. Consequently, he refused to even convey the proposal to Gandhi. Although it seems she did eventually find out, Gandhi, in turn, decided to postpone any trip to China till after the elections due in 1985. Alas, she was assassinated before that happened. Thus was lost the best chance we've had of resolving this festering border dispute.

Saran is too diplomatic to attribute blame though he hints at it. Yet the truth is that at critical moments an inability to take tough decisions resulted in potentially far-reaching solutions slipping out of our grasp. History, as a result, did not turn leaving us stuck in old ruts.

If similar opportunities come Narendra Modi's way will he act differently?

LETTERS

Ensure uniform education

With reference to the editorial, "The NEET problem" (September 5), that schools follow the state board syllabus and its students then have to take an eligibility/entrance test based on the CBSE syllabus goes against the principle of natural justice.

Obviously, students with "inherited privileges", who studied in schools following the CBSE syllabus, have an advantage in the National Eligibility-cum-Entrance Test over those without such privileges and studying in schools following the state board syllabus.

The central government cannot justify its insistence on a uniform entrance examination without putting in place a uniform education system for all students.

Schools across the country should have the same syllabus — it is hard to interpolate Hindutva into science textbooks — equal facilities and teachers of the same calibre.

Expenses for running the schools (of the same standard) should be borne by the government.

NEET is an instrument to enable "elitist" students to get admitted into medical colleges in disproportionate numbers. It forecloses the doors to medical colleges for poor students from humble backgrounds.

A student who got 1,176 marks out of 1,200, with 100 per cent in the core subjects in the state board examinations, cannot be said to be less qualified than a student, who cleared NEET, to get admitted into a medical college.

Dalit student Anitha would have made a great doctor, were she given an opportunity. That was not to be. The central government refused to accede to the request of the Tamil Nadu government to exempt the state from NEET. This led to Anitha's life being snuffed out and the pretension of the Bharatiya Janata Party at the Centre to ensure social justice and cooperative federalism being exposed.

G David Milton Maruthancode

Task ahead for Prabhu

The editorial, "A formidable agenda" (September 5), highlights the tasks before new Commerce Minister Suresh Prabhu (*pictured*). No doubt, his role is significant at a time when exporters are facing post-goods and services tax hurdles, declining exports, an appreciating rupee and trade imbalance with several countries.

A recent NITI Aayog report suggests inter-alia import substitutions as one of the measures to curtail under-employment in the country. The suggestion is timely and should be taken into consideration. Import substitution plays a pivotal role in creating jobs and minimising foreign exchange outgo on various goods and services.

The government directive to all departments to identify high-volume imports from China is the right step to change the open general licence policy with that country; this kind of study is needed also for those countries with which India has free trade agreements — be it China, South Korea, Thailand or the Philippines.

Prabhu has an opportunity to push import substitution policies, especially when his ministry is undertaking a mid-term review of Foreign Trade Policy (FTP). All FTP provisions should be fine-tuned, with an emphasis on import substitution and exports.

Prabhu should also focus on pruning the list of prohibitive export items and put in place sustainable and inclusive trade policies with ASEAN countries, as most of them are facing protectionist policies from developed nations.

The role of Export Promotion Councils and commodity boards should be redefined; they should be made more responsible and accountable to avail of Market Development Assistance from the commerce ministry.

Exporters, importers and all other stake holders are hoping for a pragmatic and effective mid-term FTP. Prabhu could revise Make in India as "Make in India for Exports" through enabling provisions in the FTP besides ensuring ease of doing business in the country.

A Sathyanarayana New Delhi

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HAMBONE

BY MIKE FLANAGAN

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The light fighter debacle

It shows how dysfunctional procurement hamstrings military

Among many other things, the new Defence Minister, Nirmala Sitharaman, would do well to study the long-running procurement of a single-engine, light fighter for the Indian Air Force (IAF) to understand how dysfunctional procurement hamstrings the military. Friday's announcement by Swedish company Saab and the Adani Group to build the Gripen E single-engine fighter in India followed a similar tie-up in June between US-major Lockheed Martin and Tata Advanced Systems Ltd (TASL) to build the F-16 Block 70 fighter and has brought the wheel full circle from 1999 when the IAF demanded 126 combat aircraft to replace its ageing fleet of MiG-21 and MiG-27 light fighters. It was originally hoped that the Tejas light combat aircraft would replace the MiGs. However, it was nowhere in sight during the Kargil conflict (1999). So the IAF decided to supplement its three-squadron fleet of Mirage 2000 multi-role fighters, which had performed well during Kargil. French vendor Dassault proposed shifting the Mirage 2000 production line to India. The idea was that if, after building the IAF's immediate requirement of 126 fighters, the Tejas was not yet available, it would be easy to build more Mirage 2000-5s.

But in 2002, burnt by the *Tehelka* sting, the government shied away from single-vendor procurement and ordered a global tender. Washington, driving for a closer relationship with India, cleared the F-16 for sale to New Delhi, the Russians offered their new MiG-29M and Saab of Sweden jumped in with its Gripen light fighter. With the simple Mirage 2000-5 solution scuppered, the IAF took two years to issue a Request for Information (RFI) to these four fighter vendors in 2004. Three years later, when the IAF issued its tender, the original plan to build an affordable, single-engine, light fighter was officially dead. Boeing had joined the fray with an offer for its F/A-18E/F Super Hornet, and the Eurofighter GmbH consortium had offered the Typhoon. Dassault, furious at losing out on an assured order and having to compete in a global procurement, dropped its offer of the Mirage 2000-5 and fielded the Rafale instead. This was now the "medium multi-role combat aircraft" (MMRCA) contest between a smorgasbord of dissimilar fighters — heavy, twin-engine fighters competing with medium, single-engine ones.

Predictably, the IAF did what air forces do and finally picked the Rafale — the most expensive heavy fighter in the fray. With a price tag that neither the United Progressive Alliance nor the National Democratic Alliance was willing to pay, the government has bought 36 Rafales for a mind-boggling €7.87 billion. That is one-and-a-half times what was budgeted for 126 MMRCA. And the IAF, down to just 33 squadrons against the 42 needed to handle a China-Pakistan collusive threat, has gone back to the start line. Thankfully, the new RFI specifies a single-engine fighter that must be built in India by the private sector. But now there are fresh questions. Will there be space for the Tejas, which is now close to completion? And can novice aerospace companies such as TASL and the Adanis graduate straight to assembling complex fighters?

A half-hearted attempt

Banks Board Bureau has been made irrelevant

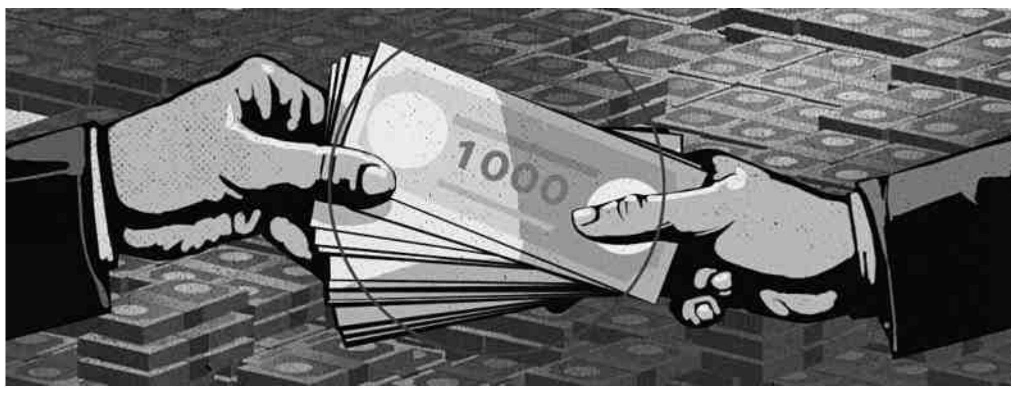
Even though India's public sector banks, or PSBs, continue to dominate the banking sector, they have been going through a severe bad loans crisis caused primarily by poor governance. The government has taken some steps towards reform, including the formation of a Banks Board Bureau headed by former Comptroller & Auditor General Vinod Rai. The Bureau was entrusted with the task of choosing the top leadership of PSBs and improving governance norms. As such, it would, if properly empowered, have been an important step towards increasing PSBs' independence and raising their level of competence. However, it is now becoming clear that the Bureau is largely toothless. Given its ineffectiveness, and in the absence of any indication that the government truly wishes to increase PSBs' independence, it is not clear why the Bureau still exists. It might as well be shut down.

The Bureau was a half-hearted attempt to implement the recommendations of the P J Nayak Committee, which had been set up to examine how the functioning and governance of PSBs could be reformed. The main recommendation of the Nayak Committee was to move towards a holding company system, to separate the day-to-day governance and supervision of the banks from the concerns of their ultimate owner, the government. As a first step towards that end, the Banks Boards Bureau was suggested. The Bureau when it was eventually formed did not have the power, as the Nayak Committee had suggested, to oversee all senior appointments, including board-level choices. It was reduced essentially to recommending names of the heads of PSBs and financial institutions. Later, even the latter power, to choose the heads of institutions such as IIFCL, IFCI, Sidbi and Exim Bank, was taken away from it and given to the finance ministry.

Subsequently, there have been several instances of its recommendations being simply ignored by the government. Rather than going to the Cabinet for approval, its recommendations are re-scrutinised and sometimes overruled by the finance ministry. Its incomplete control over the choice of members of bank boards is also clearly visible. Some new members of boards — "non-official directors" — are also members of the ruling Bharatiya Janata Party, which calls into question the whole attempt to depoliticise the functioning of PSBs. Other recommendations from the Bureau, such as over the pay of senior PSB executives and an attempt to aid in the resolution of stressed assets, have not met with approval from the finance ministry.

The government began the process of PSB reform with some energy, convening meetings of bank heads and launching the so-called Indradhanush reform programme. However, this has not been followed up by any real action. The one thing it could point to as an improvement, the Banks Board Bureau, has been rendered irrelevant. The government needs to either come up with a real road map for PSB independence and reform or stop pretending that it is making the attempt — and shut down an increasingly irrelevant Banks Board Bureau.

ILLUSTRATION BY AJAY MOHANTY



Demonetisation: An interim assessment

If there's truth in the allegation that note ban was a hasty decision, declaring it a complete failure may be equally so

ASHOK K LAHIRI

Demonetisation of the old ₹500 and ₹1,000 notes — specified bank notes (SBN) henceforth — accounting for over four-fifth of currency in circulation on November 8, 2016, was described by critics as an "all-India unannounced strike", "organised loot and legalised plunder" and a hasty decision.

Did demonetisation produce only the painful cash shortage until March 13, 2017 and disruption of economic activity? The Reserve Bank of India's (RBI) Annual Report for 2016-17 and the Central Statistical Organisation's (CSO) estimate of gross value added (GVA) in the first quarter (Q1) of the current year, released last week, contain useful pointers.

Cash lubricates the wheels of business. Growth of GVA at constant prices was affected by the post-demonetisation cash shortage. After increasing from 7.2 per cent in 2014-15 to 7.9 per cent in 2015-16, it declined to 6.6 per cent in 2016-17. Indeed, a part, but not the entire decline, is due to demonetisation.

Even without demonetisation, an underlying declining trend was at work with a slowdown in investment. This investment slowdown in turn was on account of what the RBI calls "waning business confidence and flagging entrepreneurial energies", or the Economic Survey, "the twin balance sheet problem". Furthermore, the soft credit market conditions with the post-demonetisation liquidity surge in banks should have partly contained the fallout of demonetisation.

Year-on-year, quarterly growth of India's GVA declined steadily from 8.7 per cent in Q4 of 2015-16 to 5.6 per cent in Q4 of 2016-17. CSO's recent release indicates that such growth remained unchanged at 5.6 per cent in Q1 of 2017-18. Now with cash shortage a thing of the past, will the dividends follow from a more honest tax culture, a less cash-intensive economy, and lower threat of fake Indian currency notes (FICN)?

It was expected that for fear of detection, a large amount of "black money" circulating as SBN would not come back for exchange or as deposits in banks. According to the RBI's Annual Report, as much as ₹15.28 lakh crore of SBN were already back by June 30, 2017. The Report does not have the figure of how much SBN was circulating on November 8, 2016. Taking the figure as ₹15.44 lakh crore, as provided by Minister of State for Finance in the Rajya Sabha on November 29, 2016, almost 99 per cent came back two months ago. It is a much larger proportion than in the two previous demonetisation exercises — 93.7 per in 1946 and 89 per cent in 1978.

The enthusiasm to come clean by paying 50 per cent tax and depositing 25 per cent without interest for four years under the Taxation and Investment Regime for Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY) before March 31, 2017 was limited. Deposit was only around ₹5,000 crore under PMGKY. The holders of black money in the form of high-value SBN exchanged or deposited the SBN at banks, before the window for doing so closed and SBN turned into waste paper. Clearly, they were not deterred by the risk of detection and the penalty if detected.

Will the unscrupulous braves rue their calculation of the risks and penalties? Information exists on who deposited how much SBN at banks before December 31, 2016. Prime Minister Narendra Modi told the nation on Independence Day that more than ₹1.75 lakh crore of such deposits are under "the scanner". If there is any truth in the allegation that the decision to demonetise was hasty, declaring the demonetisation a complete failure now may turn out to be equally so. The past pain of demonetisation will appear tolerable, and even worth suffering, if and when the people are informed about tax evaders successfully detected, the amounts involved and the resultant penalties.

Remonetisation has entailed additional cost of printing and distributing the new notes. The RBI's printing cost was up at ₹7,965 crore during 2016-17 (July–June), from ₹3,420 crore a year ago. It contributed to the decline in the RBI's surplus payable to the central government from ₹65,876 crore in 2015-16 to ₹30,659 crore in 2016-17.

Currency in circulation, after declining precipitously right after November 8, 2016, has revived with remonetisation. But, still as a proportion of gross domestic product, it was still at 8.8 per cent at end-March 2017, down from 12.2 per cent a year ago. The fillip to the digital payment mode from demonetisation is welcome. It reduces transaction costs and promotes transparency. However, it also reduces the RBI's income. The RBI uses currency in circulation — a non-interest bearing liability — to acquire income-yielding assets such as government securities and loans to banks. Furthermore, a decline in currency also increases the money multiplier with implications for monetary planning. The RBI's Annual Report has a cryptic discussion of how the money multiplier has changed as a result of the decline in currency, but is silent on the implication for the central bank's net income, going forward.

Demonetisation also had the objective of curbing the menace of FICN. According to the Annual Report, FICN detected by banks and the RBI in 2016-17 was 0.32 million old ₹500 notes and 0.26 million old ₹1,000 notes amounting to only ₹41.5 crore. The FICN problem has still not assumed disastrous proportions. It is reassuring like the doctor ruling out, after a medical test, the risk of an immediate cardiac arrest.

Like the medical test detecting some troubling signs like elevated LDL cholesterol level, demonetisation has allowed the RBI's Annual Report to provide some rich insights on FICN from the two-stage-cluster-sampling-based scrutiny of SBN at currency chests and at the RBI. First, at the RBI's currency verification and processing system, between 2015-16 and post-demonetisation 2016-17, the number of FICN for every million pieces of notes more than doubled from 2.4 to 5.5 for ₹500 notes, and from 5.8 to 12.4 for ₹1,000 notes. Furthermore, the extent of FICN per million pieces at currency chests was considerably higher than at the RBI — 7.1 compared to 5.5 for ₹500 denomination and 19.1 compared to 12.4 for ₹1,000.

Hitler's effort to flood the United Kingdom with fake pound notes during the Second World War or Stalin's effort to counterfeit $100 notes in 1928 were nipped in the bud only by timely action. Geopolitics being what it is in the sub-continent, the useful post-demonetisation insights about FICN need a careful follow-up.

The writer is an economist

Barbarians at the monetary gate

ANDREW SHENG & XIAO GENG

Financial markets today are thriving. The Dow Jones industrial average, the S&P 500, and the Nasdaq composite index have all reached record highs lately, with emerging-economy financial markets also performing strongly, as investors search for stability amid widespread uncertainty. But, because this performance is not based on market fundamentals, it is unsustainable — and very risky.

According to Mohamed El-Erian, the lost lesson of the 2007 financial crisis is that current economic-growth models are "overly reliant on liquidity and leverage — from private financial institutions, and then from central banks." And, indeed, a key driver of financial markets' performance today is the expectation of continued central bank liquidity.

After the US Federal Reserved revealed its decision last month to leave interest rates unchanged, the Dow Jones industrial average set intraday and closing records; the Nasdaq, too, reached all-time highs. Now, financial markets are waiting for signals from this year's meeting of the world's major central bankers in Jackson Hole, Wyoming.

But there is another factor that could further destabilise an already-tenuous leverage- and liquidity-based system: Digital currencies. And, on this front, policymakers and regulators have far less control.

The concept of private cryptocurrencies was born of mistrust of official money. In 2008, Satoshi Nakamoto — the mysterious creator of bitcoin, the first decentralised digital currency — described it as a "purely peer-to-peer version of electronic cash," which "would allow online payments to be sent directly from one party to another without going through a financial institution".

A 2016 working paper by the International Monetary Fund distinguished digital currency (legal tender that could be digitised) from virtual currency (non-legal tender). Bitcoin is a cryptocurrency, or a kind of virtual currency that uses cryptography and distributed ledgers (the blockchain) to keep transactions both public and fully anonymous.

However you slice it, the fact is that, nine years after Nakamoto introduced bitcoin, the concept of private electronic money is poised to transform the financial-market landscape. This month, the value of bitcoin reached $4,483, with a market cap of $74.5 billion, more than five times larger than at the beginning of 2017. Whether this is a bubble, destined to collapse, or a sign of a more radical shift in the concept of money, the implications for central banking and financial stability will be profound.

At first, central bankers and regulators were rather supportive of the innovation represented by bitcoin and the blockchain that underpins it. It is difficult to argue that people should not be allowed to use a privately created asset to settle transactions without the involvement of the state.

But national authorities were wary of potential illegal uses of such assets, reflected in the bitcoin-enabled, dark-web marketplace called Silk Road, a clearinghouse for, among other things, illicit drugs. Silk Road was shut down in 2013, but more such marketplaces have sprung up. When the bitcoin exchange Mt. Gox failed in 2014, some central banks, such as the People's Bank of China, started discouraging the use of bitcoin. By November 2015, the Bank for International Settlements' Committee on Payments and Market Infrastructures, made up of 10 major central banks, launched an in-depth examination of digital currencies.

But the danger of cryptocurrencies extends beyond facilitation of illegal activities. Like conventional currencies, cryptocurrencies have no intrinsic value. But, unlike official money, they also have no corresponding liability, meaning that there is no institution like a central bank with a vested interest in sustaining their value.

Instead, cryptocurrencies function based on the willingness of people engaged in transactions to treat them as valuable. With the value of the proposition depending on attracting more and more users, cryptocurrencies take on the quality of a Ponzi scheme.

As the scale of cryptocurrency usage expands, so do the potential consequences of a collapse. Already, the market capitalisation of cryptocurrencies amounts to nearly one-tenth the value of the physical stock of official gold, with the capability to handle significantly larger payment operations, owing to low transaction costs. That means that cryptocurrencies are already systemic in scale.

There is no telling how far this trend will go. Technically, the supply of cryptocurrencies is infinite: bitcoin is capped at 21 million units, but this can be increased if a majority of "miners" (who add transaction records to the public ledger) agree. Demand is related to mistrust of conventional stores of value. If people fear that excessive taxation, regulation, or social or financial instability places their assets at risk, they will increasingly turn to cryptocurrencies.

Last year's IMF report indicated that cryptocurrencies have already been used to circumvent exchange and capital controls in China, Cyprus, Greece, and Venezuela. For countries subject to political uncertainty or social unrest, cryptocurrencies offer an attractive mechanism of capital flight, exacerbating the difficulties of maintaining domestic financial stability.

Moreover, while the state has no role in managing cryptocurrencies, it will be responsible for cleaning up any mess left by a burst bubble. And, depending on where and when a bubble bursts, the mess could be substantial. In advanced economies with reserve currencies, central banks may be able to mitigate the damage. The same may not be true for emerging economies.

An invasive new species does not pose an immediate threat to the largest trees in the forest. But it doesn't take long for less-developed systems — the saplings on the forest floor — to feel the effects. Cryptocurrencies are not merely new species to watch with interest; central banks must act now to rein in the very real threats they pose.

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Hinduism as it is lived

BOOK REVIEW

C P BHAMBHRI

The end of the Cold War created new global antagonisms. As Harvard professor Samuel Huntington's memorable "clash of civilisations" posited, the future fault lines of international conflicts would occur around the major religions of the world. He was talking specifically of Islam and Islamic militancy versus the Christian West, but the western academic world responded to this trend of religious militancy by expanding religious studies in university curricula. This is the context of the voluminous writings on Hinduism, beginning with the last decade of the 20th century, of which this edited volume is an example.

The book consists of 20 scholarly contributions, and unlike other books on Hinduism in which the authors interpret and explain this religion on the basis of scriptures and great traditions, this one focuses attention on "lived Hinduism". Anthropologists, sociologists and other scholars have presented different aspects of the religion by studying the daily lives of Hindus following the many different "traditions" that constitute this tradition.

What are their broad findings? As the editors observe, "For Hinduism, the meaning of 'tradition' is cumulative, not unchanging…". Further, religion continues to dominate the daily lives of most people in the most modern city and "here modernity intimately interacts with religion". Thus, the editors warn those who project Hinduism as a monolith that "the diversity of Hinduism is legendary". This "lived diversity" is presented in eight parts: Worship; The Life Cycle; Festival; Performances; Guru; Caste; Diaspora; and Identity.

One story in section II offers an interesting account of a conversion of sorts that highlights the innate flexible nature of the religion. It is a story of a monk in the Ramakrishna Monastery, a German who wanted to become a Sadhu. But because of his birth, the Brahmanical order ordained he was not entitled to *sanayas*. To get round this, the German aspirant was told to imbibe raining from different swamis. "You live like us and we will make you one of us," he was told.

Part III shows how all festivals are linked with religion. On Holi, the authors provide an anthropological interpretation based not on the basis of sacred texts but on the observation of myriad rituals in rural India to understand the meaning of myths. "What both, I and the villagers, had taken to be their timeless living tradition within a primordial local myth of Krishna appeared instead to represent rather the latest in a legendary series of revivals and reinterpretations mingling local, regional, and even some quite remote moments of religious fashion," the author writes.

The book highlights what we all know well: That unlike other major world religions, Hinduism is an evolving and dynamic system of rituals and beliefs

This ties in well with chapter 9, "A Ramayana on Air", which focused on putting a video epic in its cultural context. It is devoted to Ramanand Sagar's 1987 blockbuster TV series presented every Sunday morning on Doordarshan, the popularity of which grew beyond all expectations. The author observes that "to most viewers, Ramayana was a feast of *darshan*", and Mr Sagar exploited the potential of the TV screen "to allow his viewers an experience of intense communion with epic characters".

The other side of Mr Sagar's hit series was that Hindu religious ritual-based identity was strengthened by this regular viewing of gods and goddesses, and this may have played its part in encouraging the forces of Hindutva to champion the cause of Ram Temple at Ayodhya, which has polarised India on religious basis since 1988-89.

The various approaches to the Goddess Durga, the role of gurus, the Bhakti movement as a message of social protest (the Dalit poet Ravidas suggesting that untouchables have their own reference points) are all put under the scrutiny of the anthropologist's microscope in this book to underline the central point of Hinduism's intrinsic diversity. A chapter on the Hindu diaspora is devoted to the way Hindus try to remain Hindus in foreign countries.

The strength of the book lies in its exposition of the intrinsic mutability of the religion in practice. It highlights what we all know well: That unlike other major world religions, Hinduism is an evolving and dynamic system of rituals and beliefs. The tragedy of Hinduism is its politicisation by the forces of Hindutva, which are constructing a mythical monolithic religion around ancient Hindu scriptures that can be interpreted only by a small Sanskrit-educated Brahman caste. This a caricature of one of the world's most dynamic belief systems.

THE LIFE OF HINDUISM
John Stratton Hawley and Vasudha Narayanan (Eds)
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