Fintech — old wine in a new bottle

Will fintech revolutionise banking services or is it more hype than substance?

THE OTHER SIDE

A V RAJWADE

In the last few months, fintech has been attracting a lot of attention; the valuations of some of the companies seem astronomically high. (Recently, a UK company attracted valuation in excess of $10 billion, well in excess of its gross earnings, and when there is no profit!) Will fintech revolutionise banking services or is there more hype than substance? In a recent paper, the European Banking Authority (EBA) defined fintech as "technologically-enabled financial innovation that could result in new business models, applications, processes or products". EBA also classified fintech services under four clusters:

- ■ Credit, deposit and capital raising services
- ■ Payments, clearing and settlement services
- ■ Investment services/investment management services
- ■ Other financial-related activities.

Given that Silicon Valley in the US is supposed to be the leader in information technology, one would have expected that country to be the leader in fintech as well. Astonishingly, it is China, which is by far the largest investor, innovator and user of fintech. To quote a couple of figures, in 2015 alone, the volume of new credit generated by fintech in China was almost $100 billion, three times what the US did (the corresponding number for India is barely $20 million). One reason for the huge amount of credit generated is the propensity of individuals to borrow and lend on peer-to-peer (P2P) platforms, which is close to 40 per cent in the case of China. While India's figure looks very small, the actual number through traditional P2P channels like venture capital and chit funds is huge. To be sure, in China's fintech-facilitated credit, a preponderant proportion is P2P, as distinct from individuals to business (peer-to-business or P2B). The use of mobile payments, also part of fintech, in China amounted to as much as $5.6 trillion in 2016 — more than twice India's gross domestic product.

Fintech also seems to have generated a large amount of cross-fertilisation in financial and, indeed, e-tailing services. On the one hand, traditional brick and mortar commercial banks are using fintech companies for assessment of credit risk on personal/consumer loans. On the other hand, some fintech companies are happy to partner banks in their payment and other services. A relatively new dimension is that e-tailers (say, Amazon and Flipkart in India) are entering the consumer loan business, taking advantage of the large customer base they already have. On the other hand, payment firms such as Paytm are invading the e-commerce arena (Paytm Mall). As mobile and card payments grow, will one day the ATM (automated teller machine) become a museum piece? Just a decade back, after the banking crisis of 2007, which was triggered by highly complex structured credit and credit risk protection instruments, Paul Volcker, former chairman of the US Federal Reserve, had described ATM as the only useful financial innovation by the banking industry.

In India, after the demonetisation exercise of last year, there was a spurt in electronic payments. In recent months, we seem to have gone back to our old habits of cash payments by currency notes.

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CHINESE WHISPERS

When eggs became a hot potato

Eggs have turned into a political hot potato in Odisha. In May, Biju Janata Dal member of Parliament Baijayant Panda was pelted with eggs — besides slippers and stones — in Cuttack. He refused to file an FIR then but has now raked up the attack himself: "No arrest has been made only in one incident... because it also involved stones and brickbats?" he tweeted. Earlier, Chief Minister Naveen Patnaik informed the state Assembly that "89 persons have been arrested in 15 egg-throwing incidents" in the state and that there had been no arrests only in one incident — the one involving Panda. Opposition leaders in the state lost no time in targeting the government on the issue. The state units of both the Bharatiya Janata Party and the Congress alleged that the ruling party was involved in the attack, so no action could be taken.

Matching the talk to the attire

On the sidelines of the BPCL annual general meeting, R P Natekar, executive director (LPG), was talking about the success of the Pradhan Mantri Ujjwala Yojana when he was accosted by an official. This official pointed out that Natekar would be the visual embodiment of the idea of "*ujala*" (light; Ujjwala can be translated to mean bright) that day. Natekar, who was dressed in spotless white, retorted in jest: "Why do you think I am wearing a bright white shirt today?"

Lalu's Twitter 'achievement'

After Bihar Chief Minister Nitish Kumar dropped the Rashtriya Janata Dal from his government, its chief, Lalu Prasad (*pictured*) has found a reason to cheer: He has notched up two million followers on Twitter. Prasad expressed his delight by tweeting that he was "the first Bihari among his lot to be in the 2M (two million followers) club" and went on to thank his followers for their love and support. For the record, his bête noire, Kumar, has 1.6 million followers on Twitter.

Long-term equity returns: Claim vs reality

Overarching claims, disclaimers give rise to wrong expectations about risk and return to the investor

DEEP NARAYAN

When on August 1, 2017, Nifty 50 touched 10,114, it gave a return (theoretical) of over 32x in approximately 27 years. While Nifty 50 was launched for trading on April 1996, it was back calculated all the way to July 20, 1990, for the purpose of index creation. From July 20, 1990, till date, Nifty 50 has given an annualised return of approximately 13.7 per cent. While such headlines create a case for long-term investment in Indian equities, it also sets wrong expectations about risk and return among retail investors. It is surprising that the market regulator feels that an overarching disclaimer, that is, "equity markets are subject to market risks" is sufficient sensitisation to investors about this risk. It's worrisome that some entities regulated by the Securities and Exchange Board of India get away by claiming that equity markets gave 15 per cent return by choosing specific base years; arguably such claims may be misleading the retail investor.

Investors who invest after knowing the divergences in long-term return, truly have the appetite for handling equity market risks and will lend to long-term stability of the market

From the launch date of Nifty 50 the current level suggests an 8.7x growth with annualised returns (including dividend) of approximately 11 per cent. Note that a change in base year for returns calculation (from 1990 to 1996) reduces annualised returns significantly.

The layman investor often concludes that:

- ■ In the past five- to 10-year holding period (or even longer) the market has given handsome returns, enough to justify the "market risk".
- ■ The returns were well above rates of bank deposits or investment in bonds.

The retail investor takes investment decisions based on an over-simplistic understanding of past returns of Indian equity. However, this understanding sometimes sets up the investor for shocks. This understanding is driven by advertisements bombarding them with overarching headlines, which hide nuances of historical return.

The bulk of the returns in the last 27 years happened in two stretches. One, between 1990 and 1992; the other between July 2003 and January 2008. However, the 11-year period between 1992 and 2003 and then again from January 2008 to August 2013, the long-term growth has been largely flat to negative.

There are two typical ways in which equity returns are calculated for public consumption. One is the way (*see Nifty 50 graph alongside*) where index values at the start and end of a multi-year period are used to calculate the cumulative return and then annualised using compounding returns. Mutual funds, while highlighting their performance, often take returns between specific dates such as April 1 as start date and March 31 as end date after one or multiple years. Then the annualised returns calculated from these very similar approaches are used to present the annual return an investor may expect for a long-term holding period.

While this method is not incorrect, it ignores a practical aspect of investment behaviour. An investor will invest on any day and likewise sell on any day, subject to markets being open for trading. Thus, it may be argued that the one, five and 10-year returns be calculated on a rolling basis and then the median or average returns be taken. This may be more representative of the "true" return. This approach also shows the variation of returns for each of these holding periods, preparing investors for negative return even for five- or 10-year holding periods.

As the table shows, the last 27 years' returns suggest that in one out of 10 instances, a five-year holding period exhibited a cumulative return (not annualised) of two per cent and, if dividend is included, then five per cent. There were 10-year investment holding periods where cumulative returns were less than 48 per cent, which is the same as a four per cent return of savings account. The retail investor must realise upfront that there are stretches of five years or 10 years where equity returns barely beat the bank savings deposit.

Sebi can do well to persuade its regulated entities to elucidate to retail investors the true nature of the market risk by sharing not just the average/median returns but also the variances in returns.

Additionally, mutual funds must be mandated to calculate their returns of rolling basis. Retail investors deserve to be communicated in simple language that median annualised returns for five-year and 10-year holding period ranges from nine per cent to 13 per cent. But there were instances where even a 10-year holding period had flat returns and stretches where five-year returns yielded negative return.

Investors who invest after knowing these divergences in long-term return, truly exhibit the appetite for handling equity market risks and will lend to long-term stability of the market. This is clearly what Sebi will also want since misguided and disillusioned retail investors cannot form the basis for a deep, sustainable market.

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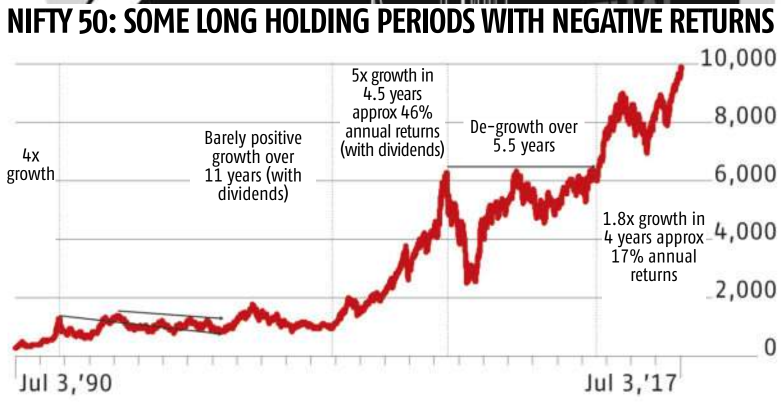
NIFTY 50: SOME LONG HOLDING PERIODS WITH NEGATIVE RETURNS



RETURNS AT A GLANCE (all figures in per cent)

	1-year return	5-year cumulative return	Annualised return	10-year cumulative return	Annualised return
Median	11	55	9	240	13
10 percentile	-20	2	0	48	4
25 percentile	-6	23	4	114	8
75 percentile	37	107	16	345	16
90 percentile	63	212	26	413	18

Returns do not include dividend, which typically averages around 0.5 per cent returns a year

BUSINESS LIFE

The terrifying power of internet censors

With only a few firms in this business, the consequences can be serious

KATE KLONICK

After the white-nationalist rally in Charlottesville, Virginia, last month where a man drove a car into a crowd, killing a counter-demonstrator, the American neo-Nazi website The Daily Stormer published a long, hate-riddled post mocking the victim.

Outcry over the article led its domain registrar, GoDaddy, to end The Daily Stormer's service. The site then registered with Google, which also quickly cancelled its hosting. It wasn't until Cloudflare, a website security and performance service, dropped the site as a client that The Daily Stormer truly lost its ability to stay online.

Because of the precise nature of Cloudflare's business and the scarcity of competitors, its role censoring internet speech is not just new, it's terrifying.

What makes Cloudflare an essential part of the internet is its ability to block malicious traffic from barraging clients' websites with requests that take them offline. Cloudflare is one of the few companies in the world that provide this kind of reliable protection. If you don't want your website to get taken down by extortionists, jokers, political opposition or hackers, you have to hire Cloudflare or one of its very few competitors.

Generally speaking, there are two kinds of corporate players on the internet: Companies that build infrastructure through which content flows and companies that seek to curate content and create a community. Internet service providers like Verizon and Comcast, domain name servers, web hosts and security services providers like Cloudflare are all the former — or the "pipe". They typically don't look at the content their clients and customers are putting up, they just give them the means to do it and let it flow. Social media platforms like Facebook are the latter. They encourage their users to create, share and engage with content — so they look at content all the time and decide whether they want to allow hateful material like that of neo-Nazis to stay up.

While there have long been worries about internet service providers favouring access to some content over others, there has been less concern about companies further along the pipeline holding an internet on/off switch. In large part, this is because at other points in the pipeline, users have choice. Private companies can make their own rules, and consumers can choose among them. If GoDaddy won't register your domain, you can go to Bluehost or thousands of other companies.

But the fewer choices you have for the infrastructure you need to stay online, the more serious the consequences when companies refuse service. This is why Cloudflare's decision to drop The Daily Stormer is so significant. Denying security service to one Nazi website seems fine now, but what if Cloudflare started suspending service for a political candidate that its chief executive didn't like?

With this move, Cloudflare is wading into the business of evaluating the content of its clients — something sites like Facebook and Twitter have been wrestling with for years, leading them to develop complex rules and procedures that govern what users are and are not allowed to post.

Last week, Matthew Prince, Cloudflare's chief executive, acknowledged how much power his company has, and what's at stake. "The internet is a really important resource for everyone," he said in an interview with TechCrunch, "but there's a very limited set of companies that control it and there's such little accountability to us that it really is quite a dangerous thing."

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LETTERS

Big opportunity

With reference to Ajai Shukla's article, "Build that carrier, quick!" (September 13), the proposed building of INS Vishal, the indigenous, nuclear-powered 65,000-ton aircraft carrier, would be the most important national defence project till date, and should be accorded the highest priority.

India missed a golden opportunity four years ago to partner with France and UK in building a similar class of aircraft carrier called the Queen Elizabeth class. It would have halved delivery time and costs. At that time, we did not have a political leadership with foresight and sagacity like that of P V Narasimha Rao, who, in 1991, signed a deal with Russia to jointly finance and develop the Sukhoi MKI Cobra air-superiority fighter, for which deliveries to India started in 1997. The first Elizabeth class nuclear aircraft carrier joined the Royal Navy this year and would be fully battle-ready by 2019.

Since the Vishal project has to start from scratch and may take 15 years, it should be handled by a separate shipyard, preferably located on India's eastern seaboard. To save time and costs, Cochin Shipyard, which is completing the 40,000-ton aircraft carrier New Vikrant, should get repeat orders for two more such ships, as it has mastered this complex technology.

J K Achuthan Thiruvananthapuram

Look beyond dynasty

Congress Vice-President Rahul Gandhi (*pictured*) made some candid observations during his address at the University of California. He admitted that he was a beneficiary of the dynastic succession in the Congress, but that the person chosen to lead the party should be picked on the basis of ability.

Gandhi's next logical step would be to introspect if he measures up to the requirements of the position. Power and position were bestowed on him as member of Parliament in 2004 and as Congress vice-president in 2013. He and his mother, Congress President Sonia Gandhi, held the reins to the United Progressive Alliance government for 10 years. But the party could not regain power in the 2014 Lok Sabha elections — it was not able to claim even 10 per cent of the seats to become the main Opposition party.

Subsequently, the party lost power in almost all the states where it was ruling earlier and posted dismal results in the Assembly polls of states such as Uttar Pradesh. The party is now in tatters and its only contribution to debates is through spokespersons such as Digvijaya Singh.

Gandhi lacks the attributes of a good leader such as courage, conviction, the ability to influence people and decisions, depth of knowledge, drive and energy, persistence and communication skills.

The Congress has several capable leaders, so it would not be a problem to select the right successor to Sonia Gandhi. The country needs an alert Opposition to strengthen the democracy.

The Congress can be rejuvenated by a competent president, who is not from the dynasty.

Y G Chouksey Pune

It could be a new start

Rahul Gandhi spoke plainly during his address at the University of California in Berkeley. That he talked about the revival of the Kashmir problem, violence creeping into society, the killing of independent journalists, the ill-effects of demonetisation and the lack of jobs angered the ruling Bharatiya Janata Party (BJP).

Union minister Smriti Irani came to the BJP's defence. She seems to have forgotten that blunders committed by the Narendra Modi government have infused new life into Gandhi's flagging political career. He even praised the initiatives of Make in India and Swachh Bharat. He also praised Modi for his communication skills and admitted that the latter is "probably much better than me".

Berkeley could mark a new beginning both for Gandhi and the Congress, provided he snaps out of his erratic approach to public and party responsibilities.

Bidyut Kumar Chatterjee Faridabad

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HAMBONE BY MIKE FLANAGAN

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Consolidation gains

Sebi has taken the right call on merger of mutual fund schemes

The Securities and Exchange Board of India's (Sebi's) initiative to redefine mutual fund categories and induce asset management companies (AMCs) to merge similar schemes is a welcome step, driving long-pending consolidation in an industry that has hitherto ignored informal requests for ending the surfeit of plans. In the long run, it will lead to more clarity and should result in lower expense ratios, making it easier for investors to select funds that suit their specific aims. The Indian mutual fund industry is one of the world's largest and consists of 42 AMCs, which together manage over 55 million folios and hold over ₹20 lakh crore in assets under management (AUM). The AUM has more than doubled in the past three years and individuals now hold around 48 per cent of the total AUM.

However, size does not necessarily translate into efficiency or low expenses. The space is bewilderingly complex with over 2,000 active schemes investing in assorted mixes across various categories of debt and equity. Globally, fund expense ratios tend to average between 1 per cent and 1.7 per cent of AUMs in most markets. But Indian funds typically charge above 2 per cent of the AUM, which is almost double that of the US and higher than any other major market, except Canada. The excessive expense adds up to over ₹150 crore per annum that is not being gainfully invested. Over time, that compounds to a massive opportunity cost.

Part of the problem lies in the current loose categorisation of equity and debt and close-ended versus open-ended funds. Funds are allowed to charge differential expense ratios for debt, equity and balanced funds. An equity scheme can charge a maximum of 2.5 per cent of the assets managed while debt funds can charge 2.25 per cent. A new fund offering can charge up to 0.3 per cent as promotional expenses for marketing in smaller towns. AMCs have an incentive to game this system to squeeze out higher charges and often float multiple schemes with different names but similar mandates.

AMCs have also been known to ignore the stated mandate and allocate assets in a fashion that the investor may not necessarily prefer. For example, a stated small-cap scheme may have substantial exposure to large-cap stocks. All this confusion makes it difficult for investors, especially individuals, to select schemes. Sebi's Mutual Fund Advisory Panel has recommended that categories should be fine-tuned and tightened, and mandates should be strictly followed. This implies a merger of similar schemes offered by the same fund house. This will make it considerably easier for investors to build rational portfolios that suit their specific need for diversification.

If the investor decides to simply continue holding some merged schemes, there are no tax implications. But this process of consolidation could have tax implications in cases where investors decide that the merged scheme does not suit their risk appetite or timeframe. In that scenario, they will sell and move to another category and there may be capital gains payable, depending on the holding period and returns. Nevertheless, the removal of ambiguity will help in the long run. As schemes become larger through this merger process, the regulator should also look at lower caps on expense ratios.

Crop insurance flaws

PM's flagship scheme needs an urgent reboot

Prime Minister Narendra Modi has done well to respond to criticism over his government's flagship farm insurance scheme, the Pradhan Mantri Fasal Bima Yojana (PMFBY), and ask the NITI (National Institution for Transforming India) Aayog to suggest ways to improve it. The scheme was launched in April 2016 and has been criticised for benefitting insurance companies instead of farmers by allowing them to pocket the bulk of the premium along with hefty subsidies. The total payout by way of claims has been just around one-fourth of the premium collected by the insurers. In the past, both the Centre for Science and Environment (CSE) as well as the Comptroller and Auditor General (CAG) have pointed out the lopsided accrual of gains.

Clearly, the PMFBY has a lot of room for improvement. It is also likely that if properly implemented with alterations, it can serve as the much-needed safety net for risk-prone farmers. That is because it is, in fact, the only scheme that covers all hazards in farming, ranging from prevented sowing to post-harvest losses. It would be a pity if this scheme is allowed to meet the same fate as that of many of its predecessors, which were either wound up or continue to operate without yielding any real outcome.

Possibly, the first element that requires correction is the way the scheme has been structured. Even though the scheme has been named as the PM's scheme in its title, yet in actual functioning state governments are required to share 50 per cent of the expenditure on its implementation. Moreover, states have been asked to conduct crop-cutting experiments to assess damage. It is hardly surprising, therefore, that the states have shown only a lukewarm interest in the scheme. Many state governments tend to delay the payment of their share of costs. They also tend to avoid expenses on crop-cutting experiments and submit only visually-assessed yield-loss data. Besides, the stipulated deployment of modern technology, such as drones and smartphones, to expedite the collection and dissemination of data and speedy computation of claims has not happened to the desired extent.

Another noticeable flaw in the scheme is the involvement of banks in its execution. Farmers have little direct contact with insurance companies. Many farmers do not even receive the policy documents or receipts. The compensation money is often adjusted by the banks against farmers' dues. The insurers, on the other hand, complain of the lack of detailed knowledge about landholdings and crop plantings by their farmer-clients. The PMFBY, moreover, is also not immune to some of the usual problems related to poor land records, corruption and ambiguity about actual land tillers. So what is the way to ensure that the huge majority of small and marginal farmers, who truly need the support of an insurance scheme, are the ones that benefit from the PMFBY? The NITI Aayog, while examining various other aspects of the programme, should perhaps consider the implications of converting it into a central scheme to enable it to meet its prime objective of hedging farmers' production risks.

DIFFERENT TYPES OF LICENSING OF INDIA'S IMPORTS 1996-97 TO 1999–2000

Number of tariff lines as per Harmonized System of Trade Classification at 10 digit level

Type of License	As on 1.4.1996 No. of Lines	As on 1.4.1996 Percentage Share	As on 1.4.1997 No. of Lines	As on 1.4.1997 Percentage Share	As on 1.4.1998 No. of Lines	As on 1.4.1998 Percentage Share	As on 1.4.1999 No. of Lines	As on 1.4.1999 Percentage Share	As on 1.4.2000 No. of Lines	As on 1.4.2000 Percentage Share
Prohibited	59	0.6	59	0.6	59	0.6	59	0.6	59	0.6
Restricted	2,984	29.6	2,322	22.8	2,314	22.7	1,183	11.5	968	9.6
Canalize	127	1.2	129	1.3	129	1.3	37	0.4	34	0.3
SIL	765	7.6	1,043	10.2	919	9.0	886	8.7	226	2.2
Free	6,161	61.0	6,649	65.1	6,781	66.4	8,055	78.8	8,854	87.3
TOTAL	10,096	100.0	10,202	100.0	10,202	100.0	10,220	100.0	10,141	100.0

Source : Directorate General of Foreign Trade, Ministry of Commerce, as reported in the author's "Managing India's External Economic Challenges in the 1990s" in his *Essays in Macroeconomic Policy and Growth*, Oxford University Press, 2006

A neglected story

Unilateral, multilateral and regional trade liberalisation strands have all played a role in the abolition of import licensing in India

A PIECE OF MY MIND

SHANKAR ACHARYA

For 30 years up to 1990 we used to operate a hideously complex system of quantitative restrictions (QRs) on imports, run by the Ministry of Commerce and the Customs administrations. Anyone remember the massive Export-Import Policy handbooks? Nearly all imports were under licensing, with the broad categories being: "Prohibited", "Restricted", "Limited Permissible", "Canalized", and "Open General License (OGL)". Prohibited meant just that and Restricted was usually very restricted, bordering on prohibited. OGL did not always mean free of import restrictions: Sometimes they were "free" for "actual users" only; traders could not import them. Some Restricted and Limited Permissible items could be imported against "Special Import Licenses" (SILs), which were linked to export earnings.

The procedures for allocating import licenses were also complex and opaque and would take me many pages to describe. Relax dear reader, I won't even try. In the mid-1980s, as freshly recruited Economic Advisers to the Department of Economic Affairs in the Finance Ministry, Prannoy Roy and I sometimes attended the fortnightly Import Policy Committee meetings chaired by the Chief Controller of Imports and Exports. When we understood the issues of particular cases, we tried (with modest success) to argue in favour of liberalisation. Mostly, we were flummoxed by the proceedings, which may have contributed to Prannoy's early departure from government service to found NDTV and go on to change the face of Indian television!

This system of tight and complex QRs on imports, together with the prevailing structure of steep and multi-rate customs tariffs, conferred high, differentiated, opaque and uncertain protection across virtually the entire domain of tradable products. The economic consequences for the development of foreign trade and efficient domestic industry were hugely negative. All this changed from 1991 onwards. However, while the post-1991 evolution of customs tariffs and exchange rates has been described often, it is hard to find good accounts of what happened to the QR policy regime. For example, in a recent review "Trade Policy Reform in India since 1991" in *India Transformed: 25 Years of Economic Reforms* (edited by Rakesh Mohan), Harsha Vardhana Singh provides a detailed analysis of the trajectory of customs tariffs but devotes only a page and a half to QRs and import licensing in his 50-page paper. But there is a story to be told. Here is a summary account.

Under the rules of the post World War 2 General Agreement on Tariffs and Trade (GATT), QRs were disallowed, except temporarily under situations of extreme balance of payments (BoP) pressure. This was under Article XVIIIB and was referred to as "BoP cover". Following the foreign exchange crisis of the late 1950s our government resorted to pervasive QRs to manage the BoP. Temporarily of course, except that we extended the notion of temporary to span several decades! I recall several trips to Geneva, with successive Commerce Secretaries, in the late 1980s and early 1990s to defend our recourse to QRs before the relevant GATT committee. It was tough going, especially as we were fully aware that, over time, our QR regime had evolved to also become a potent instrument for protection of domestic industries.

Fortunately, in the initial burst of trade policy liberalisation in the early 1990s, QRs on imports of raw materials, intermediates and capital goods were eliminated and the results codified in the landmark Export Import Policy of 1992. This meant that about 60 per cent of tariff lines (at the 10-digit level of the Harmonized System of trade classification) became free of QRs and licensing. The great bulk of the remainder were consumer goods on which the policy decision was deferred, partly on technocratic grounds of phasing reforms and, importantly, to reflect a politico-administrative bias against imported consumer goods. Over time, the latter factor became dominant, buttressed by domestic interests which benefitted from the protection conferred by the QRs. Thus, the proportion of tariff lines free from QRs was still stuck at 61 per cent in 1996 (*see table*).

However, following the dramatic improvement of our BoP position after 1993, as a result of the trade and exchange rate reforms of the early 1990s, our interlocutors in GATT (namely other member nations) became increasingly impatient with our continued recourse to BoP cover under article XVIIIB. Under growing pressure from major trading partners, led by the US, we offered a six-year phase out of our BoP-justified QRs (preponderantly on consumer goods) beginning 1997. While our other major trading partners agreed, the US didn't and "took us to court" under the World Trade Organization's (WTO's) dispute settlement procedure. We lost and had to eliminate QRs by April 2001. Consequently, in the two years between 1998 and 2000, the share of Restricted, Canalized and SIL tariff lines fell from 33 per cent to 12 per cent, while the share of free imports climbed to 87 per cent. By 2001 over 95 per cent of our tariff lines were free of QRs and we had duly met our WTO obligations. Restrictions remained on a number of items for reasons of health, safety, environment and culture/morality.

In the final years of QR elimination, there were apprehensions about surges in consumer good imports and a "war room" had been established in the commerce ministry to monitor such eventualities. In the event such apprehensions proved exaggerated: There was no dreaded surge in consumer good imports; the market-determined exchange rate and prevailing customs tariffs did their work.

Actually, there had been something of a dress rehearsal to the elimination of QRs on consumer goods under WTO decision. In the 10th SAARC (South Asian Association for Regional Cooperation) summit of 1998, held in Colombo, Prime Minister Atal Bihari Vajpayee announced the removal of QRs maintained on BoP grounds for imports from member countries of the SAARC Preferential Trading Arrangement (SAPTA), with effect from August 1998 and subject to SAPTA rules of origin. Then too there was no surge in imports.

An interesting feature of this story of liberalisation of India's imports from licensing restrictions is the manner in which unilateral, multilateral and regional trade liberalisation strands have all played a role at different times in different ways.

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

High Speed Rail: A necessary step forward

NEELKANTH MISHRA

A decade after Indian Railways first proposed High Speed Rail (HSR) routes, the foundation stone for India's first HSR link, between Ahmedabad and Mumbai, will be laid on Thursday. In five or six years, when the trains start running (as per the plan), the travel time between the two cities should fall from the current 6-8 hours to just above 2 hours (for the two-stop journey; one that stops at all 12 stations would take about 3 hours). The 508 kilometre project is expected to cost ₹1.1 lakh crore, by far the most ambitious project ever undertaken by the Railways.

A plethora of problems plague the Railways, including ones related to safety and timeliness, and a potential debt trap (as salaries and pensions account for more than two-thirds of revenues, and structural adjustments to key revenue drivers such as coal, iron ore and food grains erode the revenue base, it is relying on debt to expand capacity). A frequent criticism therefore has been whether the funds being used for HSR would not have been better used in improving safety and expanding traditional rail capacity.

But that is an unnecessary debate, in our view, as HSR does not preclude action elsewhere. In any case, funds available for this project (a subsidised loan from Japan funding more than 85 per cent of the project: A 50-year loan at 0.1 per cent interest with a moratorium for 15 years) would not be available for other purposes. Cheap financing is a routine tactic to win such business as there are only a handful of locations globally where HSR may work, and three consortiums, one each from China, Japan and Europe, are chasing them. You need two populous and relatively rich cities (capable of generating 10-40 million rides per year) separated by 500 to 1,000 kilometres (any less, and the train does not have the space to accelerate or slow down; any more, and airlines start to become more competitive). India has already identified nine HSR routes: Locking this future demand in would clearly be the attraction.

Can the project be economically viable? Access to nearly free capital does bring down the hurdle rate for financial returns, but with Mumbai-Ahmedabad air tickets for next week costing less than ₹2,000, will there be 15 million passengers a year at the targeted ₹2,500-3,000 ticket price?

It is important to understand that, in addition to pulling traffic from air, rail and road, HSR also generates it. That is, people start travelling because the option is available. In China, nearly half the traffic has been found to be generated. HSR targets "day return" traffic: It may take the "fast" train an hour to get from Surat to the Bandra Kurla Complex (BKC, the financial hub of Mumbai), and cost ₹35,000 a month. If a few thousand BKC workers choose to stay in Surat that would be a million trips a year. Will Thane, Virar and Boisar (all planned stops), or even Vapi become attractive options to live for those working in Mumbai city, or Vadodara, for those working in Ahmedabad? Unlike air travel, cities that lie in between also contribute to traffic. Mumbai airport eventually shifting outside the city would also add to HSR's advantage.

Further, as per the OECD, revenue is only 30 per cent of the "gross benefits" from HSR. Nearly 50 per cent could be rail user time savings (including from improved reliability): These economic benefits may not accrue to the Railways, but help justify the trip. The environmental impact of a fully functional HSR is also meaningful, as CO2 emissions are only a fraction of those from planes or cars. It takes a while though for these gains to offset the CO2 emissions caused by the construction of the line.

HSR started with the Shinkansen in Japan in 1964, spread to Europe in the late 1970s, and saw increased adoption there in the 1990s. The Chinese started two decades ago and now account for nearly two-thirds of all HSR track globally, with more than 20,000 kilometres constructed and another 25,000 in the pipeline. Their initial capital investments in HSR were six times than rail revenues. Now, busier routes such as Shanghai-Beijing have become profitable, and the economic transformation brought about by HSR is well acknowledged, even as questions remain regarding the viability of their more ambitious remote links. For India, it is now important to experiment with this technology.

In an otherwise investment starved economy, this is an example of routing low-cost surplus capital available globally to build infrastructure in the country. Similar to the Delhi Metro Rail Corporation becoming a consultant to metro rail projects across the country, if successful, this project could play a similar role for HSR. Gaining experience of under-sea tunnels and advanced signalling technology could be added benefits.

Like any project, however, execution is what will eventually matter: Delays add meaningfully to cost, and upend the underlying economic rationale. Given the broader goals of technology transfer and up-skilling, the project will also need to balance mandatory sourcing from Japan (the reason for the cheap funding), with indigenisation of procurement ("Make in India" is a target too).

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Debating reforms

BOOK REVIEW

ISHAN BAKSHI

Is "economic reform" still a bad phrase in the Indian political discourse?

Consider the evolution of arguments in public discourse since the turn of the century. Many commentators offered two reasons for the National Democratic Alliance's (NDA's) surprising loss in 2004. First, that the much-touted reforms had failed to have a meaningful impact on the lives of the poor. And second, that proponents of reforms weren't politically strong enough to sway elections.

That the United Progressive Alliance (UPA) in its initial years shied away from major initiatives, such as disinvestment pushed by it predecessor, may have helped push this narrative.

But have things changed since then? How do political parties view reforms? Are they as antagonistic to reforms as is made out to be? Or is their position a matter of political expediency?

The ungrammatically titled *The Future Of Indian Economy*, edited by Yashwant Sinha (former finance minister and arguably one of India's better incumbents in North Block) and Vinay K Srivastava, elaborates on these issues.

Mr Sinha lists four possible explanations why economic reforms have not been accepted in India. But these explanations, to put it charitably, fail to pass muster.

At the top of his list is the colonial hangover.

"The East India Company's experience is deeply rooted in the Indian psyche. So all foreign enterprises and foreign investments are looked upon with suspicion. Anyone who pleads for them, collaborates with them is also looked upon with suspicion," he says.

Equating reforms with foreign investment is precisely where some proponents of reforms go wrong.

The much-needed factor market reforms or, for that matter, improving the ease of doing business are not needed to line foreigners' pockets but to improve the productivity of indigenous firms and make them more competitive.

Later, Mr Sinha says pro-reformers have damaged the cause of reforms by always identifying economic reforms with foreign investment. He is guilty of doing the same.

Another popular explanation is that reforms have failed to impact the lives of the poor.

"Twenty-five years of economic reforms have made very little difference to their lives. If it does not touch the lives of the vast majority of people, they will have little interest in economic reforms," he writes.

As a former finance minister, Mr Sinha must know that reforms over the past decades have helped lift millions above the poverty line. In fact, the pace of poverty decline has accelerated in the past decade. Yet he chooses to ignore facts that are visible even to the ordinary Indian. The debate on reforms — or the lack of it — in India needs to be examined at many levels.

First, disregarding the convenient rhetorical positions that the two major political parties end up taking, is there an actual difference of opinion on what constitutes reform? Does opposition to certain reforms fade over time? And is incrementalism a better strategy to adopt in the face of opposition?

On the argument of political opposition, consider the case of fuel pricing.

All parties have at some point clung to the administered price mechanism regime fearing an electoral backlash if crude prices soared.

Yet step by step, successive governments have dismantled this regime.

Opposition may exist. But it has been relatively muted. There has been continuity in policy despite the rhetorical positioning by the two major political parties.

In the case of land acquisition, however, little seemed to have changed. The current NDA government's attempt to change the UPA's law failed to get cross-party support.

These examples would suggest that perhaps Mr Sinha's claim of political opposition and a lack of consensus on reforms is not as straightforward as it seems. The reality is more nuanced.

Mr Sinha also argues, and perhaps rightfully so, that "the constituency for reforms is limited to the government of the day, economic commentators, the corporates and the English newspapers."

Perhaps it should be seen more as a failure to communicate the benefits from reforms down the line. Or of how the sharp growth in tax revenues post reforms has given the Indian state the capacity to launch massive welfare programmes such as the rural employment guarantee scheme.

On how to make reforms more palatable, Mr Sinha's four-pronged approach is even less convincing.

"The content of the reforms programme must touch and seen to be touching the lives of the people. Provision of basic amenities especially for the poor in both rural and urban areas must be the starting point," he writes. This is a motherhood statement that scarcely addresses the institutional infirmities in governance structures that act as hindrances to efficient public service delivery.

And although he advocates greater patience with the political process, he writes that "politicians and political parties are risk averse and would never like to put the existence of their government or their political future at stake for the sake of economic reforms." Really? Even when reforms delivers jobs?

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