Business Standard
VOLUME XIV NUMBER 24

Lightning calls

Dayanidhi Maran became the country's (youngest) communications minister because his granduncle (M Karunanidhi), who leads an important constituent of the United Progressive Alliance (UPA) wanted him there; so it is only appropriate that he step down when he has lost favour with the same granduncle. How he lost favour is a fascinating story in its own right, since it involves a clash between business and media interests and a political dynasty. A Maran-owned newspaper published an "opinion poll" on who should succeed the ageing Mr Karunanidhi in Tamil Nadu as head of the Dravida Munnetra Kazhagam and as chief minister. Mr Karunanidhi thought this was designed to cause a split between his two sons, who are active in politics. Since he was perhaps unable to move against Mr Maran's elder brother, Kalanidhi Maran (who runs the Sun media group), the axe fell on the younger Mr Maran—a fact that does not speak well of the basis on which ministers are appointed or step down. The even larger embarrassment is that Mr Maran was chosen to lead the communications ministry even though his brother runs a broadcasting empire whose fortunes are affected by decisions that the ministry has to take. The manner in which the ministry dealt with Tata-Sky brought the conflict of interest out in the open.

What of Mr Maran as a minister? Certainly, he had little patience for the regulatory structure which had been put in place; so, he announced a new tariff plan (One India) though it was the telecom regulator's (the Telecom Regulatory Authority of India, or Trai) job to do this, and a stony relationship with the Trai chief ensured that he did not act on its recommendations for more than a year, on occasion. Indeed, when Trai was moving at long last to reduce the access deficit charge, which helped the public sector Bharat Sanchar Nigam, Mr Maran initiated paperwork to issue a directive that would prevent Trai from doing this. As the minister in charge, he refused to accept Trai's recommendations that asked the public sector telecom service providers to allow access to their customers; in another, he arbitrarily changed the definition of a service to hit private Internet providers in order to protect the same public sector firms. And he refused to take action when BSNL was found to be acting as a monopolist and delaying connectivity to competitors.

Against this negative record, Mr Maran's positive contributions were commendable. It was during his tenure that the limit on foreign direct investment in telecom was raised to 74 per cent; and he fought hard to defeat the move by the security establishment to impose unrealistic controls on foreign investors. And while it is true Maran had little patience for Trai, the regulator did make some recommendations that were beyond the pale. In one case, it protected the incumbent long-distance service providers by putting up high entrance fees and onerous rollout obligations for new players—Mr Maran slashed the entrance fees and removed the obligations, which has resulted in more players coming into the sector. When Trai recommended that 3G spectrum be allotted to the existing mobile phone firms by right, Mr Maran realised that this meant no new player would ever be allowed to enter the sector, and sat on the recommendations till a new Trai chairman came up with more sensible recommendations.

On balance, it would be fair to say Mr Maran did a good job for the country. As for Tamil Nadu, his home state, the results are obvious if you see the number of software and hardware firms that have set up shop there in the last three years, or are in the process of doing so.

Interim solution

The conditional vacation by the Supreme Court last week of the eight month-old stay on conducting field trials of genetically modified (GM) crops prior to their release for commercial cultivation, serves a limited objective but stops short of resolving the contentious issue. The main fear of the petitioners who had objected to these trials was that alien genes incorporated into GM crops could escape from these fields to contaminate crops growing near-by. Since the toxicity and other health hazards of such genes were not fully known, such genetic contamination of food and other crops could have undesirable repercussions. From that viewpoint, the apex court has done well to put riders like a mandatory 200-metre isolation distance from neighbouring farmers' fields of similar crops, and better scientific supervision of GM trial fields. This should minimise the risk of unintended consequences.

That said, the court order is unlikely to satisfy the bioscience companies, both national and multinational, which have invested heavily in producing GM seeds specific to Indian conditions. For, the court has allowed the trials of only those GM crops for which the Genetic Engineering Approval Committee (GEAC) has already granted approval, and not for putting fresh GM crops into field trials. As such, a large number of other GM crops for which applications are pending with the GEAC will have to wait for some more time.

Another critical, as also controversial, facet of the verdict concerns disclosure in court of data on toxicity and other such traits of under-trial GM crops. This is a piece of information which many treat as a commercial secret, under trade-related intellectual property rights (TRIPs). It may be worth recalling that insufficient experimental trial data protection was among the reasons cited by the US recently for keeping India on the watch list for intellectual property issues. This, therefore, is a much broader issue that needs to be addressed as it has implications for not only agri-biotechnology but also for other bioscience-based sectors, notably the pharmaceutical industry.

India, despite its large and fairly competent scientific manpower, is still a greenhorn in frontier technologies like molecular biology and biotechnology. As a result, Indian farmers have been denied adequate opportunities to raise production and reduce costs through GM crops. The farmers' keenness to adopt GM varieties is apparent from the pace at which Bt-cotton, the only GM crop on the approved list, has spread regardless of the allegations that companies were pricing GM seeds very high. Indeed, GM crops no longer need to be viewed as a luxury. They are a necessity, since conventional plant breeding has failed to end the yield stagnation in most crops. Of course, the bio-safety concerns raised by activists should get due consideration because these are not factors that profit-driven companies will worry enough about without external prodding; this is even more important when it comes to GM food crops, unlike a GM fibre crop like cotton. It is only when such concerns are properly addressed that GM crops will gain full acceptance and deliver their full potential.

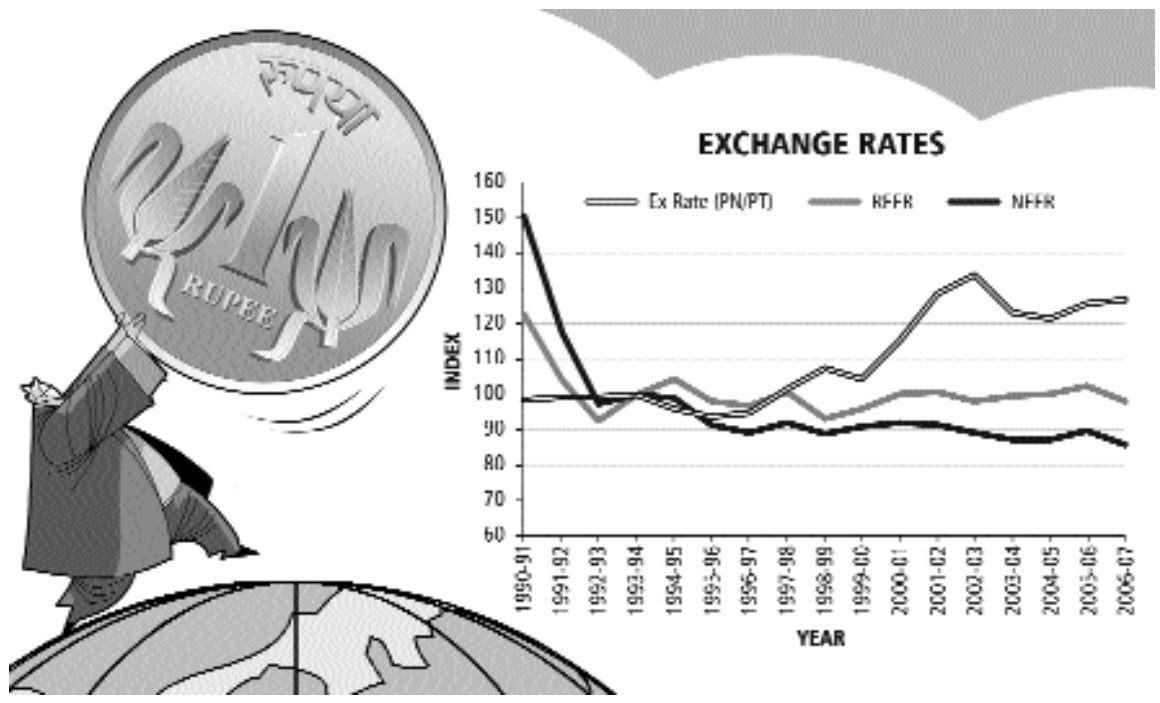

Illustration: BINAY SINHA

Exchange rate muddles

If instead of appreciating the nominal exchange rate it is devalued, the price level will rise, says DEEPAK LAL

Judging by the recent columns in this newspaper by eminent economists, some of them seem to have been touched by a dose of summer madness. The most egregious is Surjit Bhalla's recent call to send Rakesh Mohan to China to learn how to maintain an undervalued nominal exchange rate (*Business Standard*, May 12). This is particularly strange coming from the author of a dissenting note to the Tarapore Committee Mark II report on capital account convertibility, who rightly made the case for a speedy and complete opening of the capital account. But if this advice is accepted—as it should be—how can poor Rakesh Mohan maintain an undervalued nominal exchange rate?

All the muddles arise because of the failure to distinguish between three crucially different definitions of the "exchange rate", and the impossibility of the authorities to target the only one which determines real variables—the real exchange rate (RER). This is the relative price of two broad classes of commodities produced and consumed in the economy: tradeable goods, whose domestic prices are set by foreign currency prices and the nominal exchange rate—the Rs/$ rate—(NER), and non-traded goods, which because of high transport costs cannot be internationally traded (like housing or haircuts), or which could be traded but have been made non-traded because of import controls. The third "exchange rate" is the real effective exchange rate (REER), which is based on purchasing power parity, and corrects the nominal exchange rate (NER) for the difference between the domestic and foreign price levels. The REER is only equivalent to the RER (for which it is often erroneously taken as a surrogate) if there are no non-traded goods in the economy. In India, even after the recent trade liberalisations, about 30% of the goods in the WPI are non-traded. The only instrument the authorities can control in the managed floating system current in India is the NER. The RER in particular is an endogenous variable being determined by the general equilibrium effects of capital inflow absorbed, the net effects of monetary and fiscal policy on domestic absorption, and the effects of terms of trade changes. Given the resulting equilibrium, changes in the NER will not affect the equilibrium RER, but only the money prices of traded and thereby of non-traded goods required for this RER.

The diagram shows the movements in these three exchange rates in India since the 1991 reforms. The REER and NER shown are the 36-country trade- weighted series computed by the RBI. The RER series is one that has been derived with various associates at the NCAER over the years. It shows first, that the REER does not mirror the RER; second, that since 1996-97, when total foreign inflow (including remittances) surged to over 6 per cent of GDP, the RER has had an upward trend; third, the near constancy of the REER since 2000-01 suggests that it is this rate (which they probably assume mirrors the RER) which the RBI is targeting by requisite movements in the nominal exchange rate and monetary policy.

The relative profitability of tradeable vis-a-vis non-tradeable goods is determined by the RER. If it appreciates (say, as a result of increased absorption of capital inflow) the tradeable sector must necessarily shrink relative to the non-traded sector. But it can still grow in absolute terms if the economy as a whole is growing rapidly. This growth being more rapid, more foreign savings are allowed to supplement domestic savings, to raise the domestic investment rate. Despite assertions by many economists to the contrary, there is no special growth-enhancing effect from artificial promotion of tradeables, which can only be brought about by restricting capital inflow, and thence lowering the rate of investment to prevent the RER appreciation which would otherwise occur.

On the monetary side, if the authorities allow the capital inflow in any year to be absorbed, domestic high-powered money will rise by an equivalent amount, which when spent will lead to an equivalent trade deficit and a foreign exchange outflow of an equivalent amount. The RBI's balance sheet will first show an increase in its foreign exchange assets equal to the inflow matched by an equal increase in its liabilities of increased reserve money. But, as this increase in money is spent, it will lead to a trade deficit equal to the capital inflow, financed by the increased foreign exchange assets the RBI acquired in the first round. The RBI's balance sheet at the end of this process of absorption will show no net increase in reserve money, nor in its foreign exchange assets. There will be no inflationary impact from the absorption of the capital inflow if the NER is truly flexible. For, the above absorption of the capital inflow will lead to an automatic appreciation of the rupee. The price level can however rise if the authorities maintain a fixed NER, through appropriate sterilisation operations, allowing only part of the capital inflow to be absorbed. For the absorption of any part of the inflow necessitates a rise in the RER. If the price of tradeables remains constant because the NER is fixed, the only way the RER can rise is through a rise in non-traded goods prices and thence in the price level.

Moreover, if the country faces a deterioration in its terms of trade (with a rise in the foreign prices of its imports relative to exports) as has happened in recent years, *ceteris paribus*, this will also require an appreciation in the equilibrium RER. If instead of appreciating the NER it is devalued, as seems to have happened in 2006-07, the price level will rise, even if the increase in money supply is not greater than that required by the capital inflow allowed to be absorbed and the extra money demand generated by a higher growth rate of output. Thus, rather than any over-expansion of money, the recent rise in the inflation rate could be due to the inappropriate depreciation of the rupee in 2006-07. The tightening of monetary policy recently undertaken would thus only damage growth.

These recent macro-economic outcomes and the muddled discussion that they have engendered once again emphasise that it is now time for India to float the rupee cleanly, confining intervention to some smoothing of the NER. This in turn requires the capital account to be opened fully to allow both economic agents to make their own portfolio decisions and to develop and deepen the necessary forward exchange markets to deal with the inevitable shocks in a dynamic global economy from changing capital flows and terms of trade.

Lessons from the rupee's rise

DOUBLE EDGE

GOVINDRAJ ETHIRAJ

Last week, I caught up with my friend Raju P, who runs a mid-size garment export business out of Mumbai. A few minutes of conversation later, it struck me how the rising rupee was hurting smaller exporters like him.

This is booking time for winter season orders from North America and Europe, particularly for someone like Raju, who manufactures sports and winter wear. With the dollar in the Rs 41-42 range and the rupee up almost 10 per cent since his last orders were signed, he feels as if the proverbial rug has been jerked out from under his feet.

"It's not just the rupee; add another 5% or so for rising costs as well. Everything from the cost of yarn to power has risen," he says. Worse, he says, buyers continue to demand lower prices. "To give you an idea, a shirt piece that could be exported for $3 five years ago now goes for around $2.20, give or take," he says.

The price pressures could have been managed, with productivity increases, as they should consistently be. But that's if only there was no China to reckon with. As it happens, there is not just China but other hungry countries in the region as well. And Chinese manufacturers, to put it simply, continue to make more and charge less. And the yuan is being held.

Over the last month, garment and textile exporters, from Ludhiana to Tirupur, have been complaining loudly about the appreciating rupee. Many have demanded, somewhat bluntly, that the government intervene to halt the appreciation and bring back the rupee to where it was. My friend Raju too feels similarly.

The larger and smarter players are safe (somewhat relatively) because their forex exposures have been capped. Many claim that they are even striking new contracts at slightly higher rates, maybe 3 to 4 per cent. That's possible, particularly for some kinds of garments. Though despite the hedging and the new orders, some industry folks are predicting a 20 per cent volume drop in June and July.

Most garment manufacturers Business Standard has been speaking to say the hedging saves them from an immediate catastrophe but things are not so clear in the medium term, which of course could be anything from three weeks to six months. But smaller players are obviously hit. Tirupur alone has thousands of them.

There are several debates at play. Should the RBI maintain the rupee at earlier levels or maintain its current strategy of managing inflation by not stepping in to buy dollars? The political answer is quite clear.

And there are several expert views on these pages, including one which suggested that RBI Deputy Governor Rakesh Mohan should be sent to China to understand their exchange rate management. Raju says the same, though he did not take names.

My questions are a little more fundamental. First, why or rather how come no one saw this coming? And second, why does industry always get so comfortable so as not to be prepared for shocks such as this?

I have no expert view on this first question, except to reiterate that no one, at least seemingly, had a clue. One day it was Rs 45 and thereabouts and the next it had zoomed to Rs 41. The rise was not accompanied by months of dire warnings, predictions and debates. Everyone assumed that the Reserve Bank would continue to intervene as it always has.

So, simplistic as it may sound, that's lesson number one. The biggest surprises in the financial markets come when most people expect them least. The stock markets have done that a few times in the last year already. And the forex markets are now following.

Second, we have an uncanny knack of settling into comfort zones. It strikes me as a little unusual that Indian garment exporters, who are exposed to one of the most brutally competitive businesses in the globalised economy, can be so unprepared for something basic like currency fluctuation back home. Let me answer that as well. They just took it for granted.

They are not alone. Most exporting companies are in the same boat, including of course the IT majors. Since currency, the one big variable, has been actively managed by the RBI for some time now, why not safely assume that the RBI would continue to do so and keep the export registers ringing?

This possibly can be a long-term strategy for export-led growth. But few seem to have connected the problems of inflation and/or interest rate management with the possible solution that the RBI did go for, at least for now. The net result is that we are in a business environment that suddenly seems a little treacherous. Contrast that with the (minus inflation worries) gung-ho, export-led confidence that India Inc enjoyed until only recently.

So, is this all gone? Not quite. In adversity, there is opportunity. While Raju is having to do some fire fighting, my friend Vijay, a fabric importer, is a little more at ease. He says that garment manufacturers who are importing fabric (up to 65 per cent of cost) from China can weather the currency shocks. Because while China can be threat, it can be an ally too. Meanwhile, his group is venturing into bio-diesel in a big way. Where, as I see it, the risks are less financial and more political. But that's another story.

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1857, the pulp fiction version

SPEAKING VOLUMES

Nilanjana S Roy

Mention the Revolt of 1857 to any educated Indian of a certain generation, and we hear the galloping-hoof rhythms of Subhadrakumari Chauhan's ode to the Rani of Jhansi playing in our heads: "*Bundeley Harbolon key munh hamney suni kahani thi,/ Khoob ladi mardani woh to Jhansi wali Rani thi*."

A century-and-a-half after the stirring events of 1857, most of us have read a wide array of books on the subject. These range from Amar Chitra Kathas to revisionist histories and eyewitness accounts. Some have read a few great works of Indian fiction and a smattering of well-known novels by the likes of John Masters or George MacDonald Fraser.

But in the two to three decades after 1857, novels about the Mutiny—to use the British nomenclature—commanded bestseller status. Most of these works of pulp fiction are remembered now only by scholars, but they tell us as much about the complexity of the British response to 1857 as a dozen well-researched histories can.

Barely two years after 1857, Edward Money published *The Wife and the Ward; or, A Life's Error*. Money's perspective was almost entirely from the contained world of the British, but he is disconcertingly sympathetic to Indians.

The novel faithfully follows the tragic fortunes of a band of British officers struggling to protect their wives, children and camp followers as Nana Sahib's men close a deadly trap around them.

And yet, in chapter two, Money has one of his characters lament: "India! how little art thou known to the mass of the English public, and yet who can doubt that thy loss would rob Britain of the brightest jewel in her crown…'Tis strange, this apathy, this ignorance on all Indian subjects…" Remember, this is barely a year-and-a-half after the Mutiny; but several of Money's characters express regret, from the Colonel of the regiment mourning the severing of ties with his men to a sensitive young army officer wincing at the inability of his countrymen—and women—to see India more clearly.

Far more stereotypical was James Grant's *First Love and Last Love*, a baroque three-volume extravaganza published in 1868. Grant included a scene where the sepoys strip and parade Englishwomen, and offers this sort of explanation: "To the brutal Mussulman and the sensual Hindu, the position occupied by an English lady or any Christian woman, seems absurd and incomprehensible; hence came the mad desire to insult, degrade and torture, ere they slay them."

Just a few years after Mutiny pulp fiction had become a genre in its own right, Philip Meadows Taylor added to it with his own mammoth page-turner, *Seeta*. Taylor was a police officer whose first bestseller, *Confessions of a Thug*, brought the words "thug" and "thuggee" into general usage. Taylor's *Seeta* set a love affair between an English army officer and a Hindu widow against the backdrop of the Mutiny. The novel offers some stereotypes, what with bloodthirsty Muslims and cunning Hindus, but it also displays Taylor's tremendous interest in India's landscapes, social and geographical, and his romantic vision of a world where Indians and the English might meet without barriers.

Flora Annie Steel's *On the Face of the Waters*, published in 1896, is lushly romantic, but it also displays great ambivalence. The novel begins with the auctioning of the menagerie of "the lately deposed King of Oude", a suitably surreal opening for her book.

She portrays Bahadur Shah Zafar as an ineffectual king—and bad poet—ruled by a wife in equal thrall to opium and dreams of power. But Steel was a sharp observer. Her novel includes portraits of the Gissings, "who preferred India, where they were received into society, to England, where they would have been out of it" as well as quick but accurate sketches of the "Bahurupas"—the Bahurupiyas—and the difference between, say, a Gujar and a Banjara. The book ends, atypically, not with an excoriation of treacherous Indians, but with a paean to the legendary soldier Nicholson.

By 1881, the Mutiny pulp fiction stage was dominated by the likes of the all-too-prolific G A Henty. *In Times of Peril* is a Boy's Own adventure where the Warrener brothers pop up in "Cawnpore" and Lucknow, and Oudh, and Delhi to save a garrison here, rescue a shrinking maiden there. Henty is cheerfully open about the quantity of loot the boys collect during their adventures.

But by the time Henty got around to writing about the Mutiny, there was no room left for ambiguity. There were only the dastardly treacherous Indians on one side and the brave, if looting-driven, flower of British manhood on the other. In a little over two decades, the ambiguity that writers like Steel or Taylor or even Edward Money displayed so freely, and the affection they showed even in their Mutiny novels for their visions of a particular India or specific Indians had died.

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