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Draw at Hong Kong

When elephants make love, there is a great deal of dust and the results are known after 18 months. With the just-concluded Hong Kong WTO ministerial, it will take even longer—around eight years, till 2013, for the world to know if the promised phasing out of agricultural subsidies by the developed countries is for real or stillborn. The world trading regime has had a close shave at Hong Kong. Since an agreement on this was the acid test for whether or not the Doha Round of trade talks had achieved anything, it must be admitted, even by the sceptics, that there has been some progress. It will be tough going in the next few months, and the final result is as yet uncertain, but there is now greater reason for hope about the end result. By pinning the developed countries down to a specific date for ending farm subsidies, the developing countries have done better than was expected. The originally proposed cut-off date of 2010 would have been better, but the European Union's budgeting calendar (it starts a new budget from 2014) dictated the timing. Trade ministers from the different countries, including India, will claim credit for the outcome because success, never mind that it is partial, has many fathers. India, in particular, can draw comfort from the fact, that unlike in the past when the coalitions it built would fray and then come apart, this time that did not happen. To the extent that Kamal Nath, the minister for commerce and industry, led that effort, he deserves to be congratulated—though a lot of hard negotiation on very substantive issues still lies ahead.

That said, it would be navel-gazing to credit Third World solidarity beyond a modest point. The hard truth is that the outcome of this ministerial had boiled down to just one thing: French willingness to budge on the agricultural subsidies issue. And that was predicated on the just passed EU budget, on which the French had locked horns with the British. Tony Blair realised he had to make a concession and proposed one, and a trade-off was hammered out over the weekend in Brussels. Once that was worked out, the French agreed to a cut-off date for ending farm subsidies, and the Americans fell in line on the cotton subsidy, so that the rich countries could do what they had to in Hong Kong. The end result is not a victory for any particular group, because countries like India will be expected to make some concessions on non-agricultural market access before the Round is completed, but what Hong Kong has managed to do is keep the talks on track for an eventually successful conclusion.

Trade, the Hong Kong ministerial has once again demonstrated, is more about politics than economics. As long as everyone keeps this in mind, progress will always be possible because politics is more amenable to deal-making than economics. At a more basic level, the world will have to ask and answer the question whether the days of the present multilateral trading regime are numbered. The system today is yielding diminishing returns to the rich countries, which see a rising threat from countries like China and India, across a broadening swathe of activities in both services and manufacturing, and now in agriculture as well. Through history, countries have abandoned the free trade principle when they felt it no longer suited their interests. The question is whether the rich countries are now drawing closer to that point, or whether their commitment to free trade survives.

Courtroom lottery

It is not easy to be a big-bulge pharmaceutical company. The US District Court's recent ruling against Ranbaxy Laboratories for marketing a generic version of Pfizer's atorvastatin (Lipitor brand), a cholesterol-lowering drug, has put the Indian company in the spotlight once again. For Ranbaxy, this is its biggest failure so far, as a lot of expectations were pinned on the success of atorvastatin. The company plans to go in appeal to the higher court, as the stakes are high. Lipitor is one of the largest-selling drugs in the world, and if the case goes in Ranbaxy's favour, the company will get six months of exclusive marketing in the US in 2007. If it fails, the drug goes off patent only in 2010.

The district court's rejection was not unexpected as a UK court had also ruled against Ranbaxy's marketing the generic drug in that country. The other big generics player, Dr Reddy's, has also met with two shocks in the past—when Novo Nordisk suspended the clinical trials of ragaglitazar in 2002 and when the US federal drug administration ruled against the company launching the generic version of the anti-hypertension drug, Norvasc, in 2004. That inevitably raises the question: is this a viable strategy for such companies?

Litigation is of course part and parcel of a generic company's thrust into the US market. And no company can hope to win them all. Other global companies like Teva and Ivax have had their share of failures in the past. Ranbaxy, having taken the generics path to become a global player, may not be deterred from continuing the quest for more approvals in the US. But with successive setbacks, an alternative route for a company like Ranbaxy would be to enter into collaborative research with other companies. Dr Reddy's, for instance, has already hived off its clinical research and out-licensing of new chemical entities (NCE) into Perlecan Pharma, with investment from Citigroup Venture Capital and ICICI Ventures.

The stock markets tend to price in these developments very early. Even in 2003, analysts had valued the Lipitor opportunity at about 25 per cent of the then stock price. The markets are about discounting the future, and with hindsight, this was a long shot. It is also worth keeping in mind that when a company fails to get approval for its drug, there is not just the loss in revenues and profits, there is also the hit on the bottom line because of the costs of drug development and the ensuing litigation. A company with the size of Ranbaxy can withstand the shock and hope to continue the fight, plus take on the market with other generic products. But for stock market investors, betting on generics is fraught with risks that are not unlike a lottery. Nothing is more illustrative of this than the fact that while Ranbaxy has fallen 6 per cent after the announcement, Pfizer shot up 10 per cent on Friday.

Illustration: BINAY SINHA

The flat tax

The future of the flat tax might lie in countries which, like the East Europeans, are moving from the plan to the market, says DEEPAK LAL

One of the most important public policy debates in many Western countries today (including the US, Germany, and the UK) concerns the introduction of a flat tax to replace their immensely complicated and highly distorted systems of taxation. This debate is best seen as part of the development of a post-Keynesian consensus on the conduct of economic policy. In this column I want to critically examine this case in this wider context and show why it may be of relevance to India.

There seems to be widespread professional and by and large public policy consensus that activist *monetary* policy based on some version of Keynesianism is counter-productive. This is largely because its effects are subject to long and unpredictable lags and its potential for being misused by politicians of every hue to further their own personal interests during the political business cycle. There is also considerable evidence that the private sector will damp any unavoidable fluctuations in economic activity and stabilise the economy if it is not disturbed by unanticipated policy impulses (see my *Reviving the Invisible Hand*, Princeton, 2006). So there is growing agreement that the best way to conduct monetary policy is to leave it to an independent central bank which follows rules rather than discretion. These rules may be adaptive, not fixed, and can adjust in a predictable way to permanent changes in real growth or financial intermediation. This essentially depoliticises monetary policy. Though not formally independent, the Reserve Bank of India in its recent actions has largely followed these prescriptions.

This leaves *fiscal* policy. The activist case for Keynesian fiscal policy was undermined even before that for its monetary cousin, as it was shown to be an even blunter and more inflexible instrument than monetary policy. This has led to the assignment of fiscal policy to deal not with the macro but the micro economy. As the case for using fiscal policy (of which tariff policy forms a part) to provide various incentives for "infant industries" or correcting other purported market failures has been undermined, in part because of the politically mediated costs of "rent seeking", there is growing recognition that the sole aim of fiscal policy should be to provide finance for the optimal provision of public goods, at the lowest cost in terms of economic welfare. The distributive aims of fiscal policy have been equally undermined by the overwhelming evidence from around the world that, redistributive taxation has merely served as a vast churning machine in which the redistribution (at least in democratic polities) usually ends up benefiting not the intended beneficiaries but the middle classes, as all political parties seek to placate the median voter.

The technocratic answer to the problem of financing public expenditure on public goods, at least economic cost, was given by public economics. This is the system of taxes recommended by Frank Ramsey (Keynes' young Cambridge colleague). It involves the taxing of goods with the most *inelastic* demand most heavily. Any tax (which is not lump sum, like a poll tax) involves a loss of what economists call "consumer surplus". This loss will be greater for any given tax rate, the more elastic the demand curve (the more sensitive consumers are to price in the quantity of the good they buy). For, the rise in the price facing a consumer from the tax will lead to a larger reduction in quantity purchased than if demand were more inelastic. Hence the Ramsey Rule for optimal taxation.

But, this rule assumes that the government is benevolent. Suppose instead it is predatory, and not merely interested in raising a *given* revenue but in *maximising* it, at least cost. What taxes would it choose? As Brenann and Buchanan (in their *The Power to Tax*) showed, it would choose Ramsey taxes! This has led to a search for a system of taxation which limits the ubiquitous fiscal predatoriness of governments. The flat tax (first advocated by Robert Hall and Alvin Rabushka: *The Flat Tax*, Hoover Press) is the answer.

In its pure version a flat tax replaces multiple marginal tax rates with a single marginal tax rate, and abolishes all the complex systems of allowances and reliefs, which governments use for social engineering, or for buying votes. A high personal tax-free allowance allows the poor to be taken out of the tax net and imparts progressivity to the system. All taxes—corporate, personal income, and commodity taxes (e.g. VAT)—are set at the same rate, amounting in effect to a consumption tax which abolishes any double taxation such as taxation of dividends.

The advantages of a flat tax are its simplicity and transparency (as Steve Forbes, the main US politician, promoting it in his *Flat Tax Revolution* notes, everyone needs just a postcard for their tax return), leading to faster economic growth, due to greater incentives to work, and the removal of various disincentives and distortions caused by existing tax distortions, including the creation of large black markets through tax avoidance and evasion. These advantages have been apparent in the many East European countries (including Russia, Estonia, Latvia, Ukraine, Georgia, and Romania), which, whilst moving from the plan to the market, have adopted flat taxes, and induced consideration of flat taxes in others (Poland, the Czech Republic, and Slovenia).

But, unlike the new East European tax systems, which were replacing a defunct *ancien regime*, in most developed countries with mature tax systems which are the result of the past political (zero sum) redistributive game over many generations, the most likely losers from a flat tax are likely to be the past beneficiaries—the middle classes—who will use the democratic process to resist it. The back tracking on the proposal in the US, Germany and probably in the UK suggests a full-blooded flat tax, maybe infeasible in these mature tax systems. Thus, the future of the flat tax might lie in countries which, like the East Europeans, are moving from the plan to the market. The Chinese are said to be considering its adoption. If the Kelkar Commission's recommendations were fully adopted in India, it would only be a small step to move to a full-scale system of flat taxes in India. This would curb the traditional fiscal predation of the state and its associated ills like the black economy, and have a favourable impact on the country's growth rate.

Why are people poor?

MOOT POINT

PADMA PRAKASH

How robust is the interface between policy and social science research in India? Are synergies being created between the two? Is the lack of vibrant, interactive research a reason for the failure of social policies?

For example, why have poverty elimination programmes and policies—and there have been many over the past five decades—that generally enjoy a consensus across the political divide, worked so poorly? Notwithstanding the huge volume of research on poverty, could it be because of the absence of dynamic linkages between policy and research that would have prompted innovation? Are policy-making processes so structured that they are unable to capture and assimilate new research from outside their narrow disciplinary and departmental perspectives?

It is, by any yardstick, a failure on the part of social scientists that other than aggregate figures of poverty decline (which in turn have generated intense debates on definitions and rate calculations) there is little data on the proportion of households that rise out of poverty and those that sink back, or move deeper into poverty. While poverty creation and poverty elimination are occurring simultaneously, (see Anirudh Krishna, "Poverty Knowledge and Poverty Action: Evidence from Three States in India" in "Policy Matters" http://www.esocialsciences.com) we are only now devising means of measuring that change. Why some households succeed in rising above the poverty line, why some don't, and others become poor over time is not simply interesting information but would be critical to the tailoring of poverty-elimination policies. A series of studies across several countries have over the last couple of years been attempting to evolve methods of measuring this movement and charting household behaviour that prompts it. [http://www.pubpol.duke.edu/krishna]. How do households negotiate their way upwards in the context of limited sources of income and goods? Without this critical knowledge of social behaviour, poverty-elimination policies cannot be effective. But we don't have that information although we have had poverty-elimination programmes and policies by the dozen over the last five decades.

But take another segment of information that these studies have gathered. In one study of 179 sample villages across Gujarat, Andhra Pradesh, and Rajasthan the researchers have documented and graded the many reasons why people have either fallen into poverty or are unable to emerge out of it. The first and the most important reason for debt—that translates into poverty—across the three states is illness and health care. Mention this to anyone in the health sector, or to welfare economists and they will tell you that they too have found evidence of this. There are independent data from the National Sample Survey that average health expenditure on all kinds of health care has risen through the 1980s and 1990s. That a country that has the third-largest number of doctors in the world lets its citizens fall into debt because of illness must surely be the most depressing of data. Why has policy been so slow to take cognisance of new and emerging data?

Krishna's paper on the study of these three states also throws rich light on what happens when illness strikes. The study uses, among other features, community recall to assess which households have moved in or out of poverty and why, checking this against other available data. Narratives track the trajectories of households over the years: Illness leads to health care expense; usually this means a progressively higher level of care that becomes less and less affordable; this leads to debt, and it also means death, surprisingly often. It is easy to assume that death translates into change in the economic base of the family and has intergenerational impact only when it is of an able and earning male member of the household. There is anecdotal evidence that this is not necessarily so. The death of a wife/daughter involves a whole range of change in household activity; the death of a child, too, has secondary repercussions for household economic behaviour. The three-state study reports how expenses on fulfilling social obligations are the second-most important reason why families fall into debt and poverty. It also records how a household's behaviour changes as they begin to move out of poverty: ensure food supplies, rent in land, put children through elementary school, patch the roof, and so on. The sets and sequence of actions are surprisingly similar across a state, though different in all the three.

There is also considerable documentation on the behaviour of households in accessing health care. Households take into consideration a variety of factors such as the hierarchical status of the member of the household, distance from health care provider, the system of medicine, perceived quality of provider, whether it is a government or private provider, and so on. Despite this balancing act, however, a single illness can devastate families. Debt because of health care expense is rising in areas where no innovative interventions have been introduced.

According to the report of the National Commission on Macroeconomics and Health (August 2005), illness and health care are heavily implicated in the impoverishment of an estimated 3.3 per cent of the country's population every year. There is then no dearth of unquestionable and reliable data on the critical role that the absence of illness and access to affordable health care play in moving people out of poverty. So why have policies—in health and for poverty elimination—not reflected or effectively acted upon such data yet?

2005: The year in Fiction

SPEAKING VOLUMES

Nilanjana S Roy

The death of the novel was confidently announced in 2000, 2001, 2002, 2003, 2004 and 2005, though some would say that the novel was first seen to be ailing about five decades ago. I like to think of 2005 as the year when the novel confounded its detractors by making a complete recovery.

If you spent the year reading nothing but Paulo Coelho and Chetan Bhagat, you still have some 10 days to redeem yourself before 2006 rolls around. For reasons of space, this is just a selection of the most interesting fiction this year, not a comprehensive listing.

Much of the fiction published in 2005 attempted to deal with contemporary history. Ian McEwan's *Saturday* wrapped its day-in-the-life of a neurosurgeon around the great London demonstration protesting the Iraq war; it ends by invoking "Dover Beach" against a more internal kind of violence, with its lines about ignorant armies struggling together on a darkling plain. Paul Auster's Brooklyn Follies brings together a delightful expert on fraud confusion and twisted histories with a mean seeking redemption after a battle with lung cancer; the ode to America and Brooklyn slams the 2000 election and stops as "the smoke of three thousand incinerated bodies:" comes pouring down on New York in a "white cloud of ashes and death".

Salman Rushdie set himself up as ringmaster of the circus that was *Shalimar the Clown*, taking on Kashmir via Nazi Germany and contemporary America. It was a rambunctious, messy novel whose big themes couldn't quite compensate for the heavy-handed clowning around. Cyrus Mistry and Siddhartha Deb chose smaller canvases but both told their stories brilliantly. Mistry evoked a Bombay on the cusp of change in *The Radiance of Ashes*, just before the stormtroopers of hate took up permanent residence in the city's psyche. Siddhartha Deb explored the hidden history of the North-East through the tangled tale of an abduction and a killing in *Surface*. And E L Doctorow's *The March*, while not directly political, explored the fractures in the US through an unflinching account of Sherman's army on the move.

Though John Banville's mannered tale of childhood's end and a man's dark past, *The Sea*, was the surprise Booker winner this year, the real surprise was the strength of every book on the shortlist. Kazuo Ishiguro's *Never Let Me Go* is not the first book to discuss human clones, but few writers have written about the social consequences of cloning with such insight, empathy and terrible melancholy. Zadie Smith's *On Beauty*, part homage to E M Forster's *Howards End*, part tongue-in-cheek send-up of academia, was a hilarious and thoroughly enjoyable read.

Among the score of heavyweights from Coetzee to Kelman who published new work this year, the most exciting came from Ismail Kadare, Gabriel Garcia Marquez and Haruki Murakami. Kadare's *The Successor* is set in a dictatorship where the upheaval is by turns comic and tragic. Murakami's *Kafka on the Shore* is a typically dense, playful work that takes in several genres at once. And Garcia Marquez' *Memories of My Melancholy Whores* is narrated by a nonagenarian who rediscovers the pleasures that are beginning to leave him through the medium of a young whore whom he spends chastely erotic nights with.

The Great Indian Novel was elusive, but the Really Decent Indian Novel wasn't hard to find. Rana Dasgupta's *Tokyo Cancelled* gave us modern-day parables and fables told by travellers stranded at the airport. Nilita Vachani's *HomeSpun* dismantles khadi nationalist stereotypes through the story of a broke and embattled freedom fighter, setting this narrative against the myths that grow up around a fighter pilot's death in free India. Altaf Tyrewala did a montage of Mumbai stories, riffling through the lives of gangsters, abortionists, handicapped grooms, bar dancers and a host of others. He does with *No God in Sight* what a stage magician does with a tricky but impressive card trick.

There was no lack of variety. Kalpana Swaminathan's *Bougainvillea House*, with its dying, malevolent protagonist, may have invented Goa Gothic singlehanded; Sudeep Chakravarti's *Tin Fish* brought the nostalgic school story up to date and Samit Basu came out with *The Manticore's Secret*, the second in his Pratchettian fantasy trilogy.

If you have room for only one Xmas stocking stuffer, pick up Gregory MacGuire's *Wicked—The Wizard of Oz* retold from the witches' point of view, with a definite R rating. In MacGuire's Oz, the Wizard is a dry, bureaucratic Dr Evil, while the Emerald City's glitter hides a nasty history of specieist violence. Dorothy is a sweet little twit who wreaks havoc with the best of intentions. Just follow the Yellow Brick Road; in MacGuire's reinvented world, it's a crooked but compelling path.

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