आकृति

2014

"Truth is ever to be found in the simplicity and not in the multiplicity and confusion of things".

-Isaac Newton

Arthashastra, The Economics Society of Miranda House

HEAD OF DEPARTMENT'S NOTE

"Reason has always existed, but not always in a reasonable form."

- Karl Marx (1843)

It is the frenzied time of the year, when the Economics Department at Miranda House is abuzz with activity. The thoughts, ideas, intellectual exchanges and the communicative pieces on economics that have been penned by the students of our department within the Delhi University campus and from students outside Delhi will now find life in the printed pages of our annual departmental magazine Aapoorti, which will be released during the annual departmental festival, Zenith 2014. John Kenneth Galbraith had once remarked that the subject of economics is "profoundly conducive to cliché, resonance with boredom". He goes a step farther to say that if people close their ears and minds to economics, they will not be ill-advised. Our students have merely tried to break that glass wall of complex and indecipherable economic ideas to make them understandable to the layman and deconstruct imposed complexities for a free and smooth dialogic exchange between students, between students and practitioners, and between students and scholars. I whole-heartedly support their endeavour, and am waiting eagerly to lay my hands on this issue of Aapoorti. I want to know what young minds are thinking and what kind of societal sensibilities they have imbibed. They must critique what has gone wrong but they should never use the tools of economics to create an exclusive world, where creation of wealth is legitimized as the be all and end all of human life.

We are living in strangely troubled times, where everyday news standards are being set, new objectives being invented, new ideas being thrown up. The trouble of 'chaos' is not necessarily a bad idea. The polity and the economy may go through chaos to come up with something ingenuous. A command economy may be passé; but we all realize that free markets are not so free. The voice of the voiceless matters, not only for good politics but also for good economics. It is this notion of good life that enthuse us to write, exchange our ideas and discuss. Aapoorti is a small step towards that.

The Editorial team has been working really hard. They have energized, mobilized, coaxed and collated their peers to write. They have decided on a theme concerning 'trade-offs'. The world of economics revolves around this idea- how much is to be given up for a little more of something else? Or, let's say the choice between "free to choose versus freedom to choose". Our young friends have taken this question forward and interviewed scholars like Lord Meghnad Desai, Dr Rajat Kathuria and Professor E Somanathan. These interviews are also part of this volume. Their year-long effort and attempt to keep debate and discussion alive will bear fruition in the pages of this magazine. I wish them success for all their efforts and will do my bit in everyday handholding as the Department Head.

With warm regards,

Nandini Dutta
Head of the Department, Economics,
Miranda House.

ACKNOWLEDGEMENT

Our special thanks to Ms Nandini Dutta, the Head of the Department, for being extremely supportive and encouraging. This time, the response to our call for articles was exceedingly overwhelming and we are grateful to all the authors from various colleges across the country for their submissions. We are indebted to Ruby Mittal, a first year student at Miranda House and Tanaya Lal, a student of architecture at Sushant School of Art and Architecture, for designing the cover of the journal. We are also thankful to *Arthashastra*, the Economics Society of Miranda House for supporting us in our endeavour. A special thanks to Kodali Tanmayee, Vice-President, *Arthashastra*, for extending financial support and for being with us throughout. We also thank Surbhi Ghai for assisting us with sponsorship. Last, but not the least, we would like to thank our readers for receiving the previous editions so well and for enthusiastically awaiting the fourth edition.

To others without whom the journal would not have materialized, we extend our heartfelt gratitude.

The Editorial Team
Aapoorti

EDITORS' NOTE

When we were handed the responsibility of the fourth edition of our annual journal Aapoorti, we were excited yet extremely nervous. Last year's edition was a huge leap forward since we had introduced two new sections- 'From the Editors' Desk' and 'In Conversation With'. The onus was now on us to take the magazine even further ahead.

This time, the theme of the cover story is 'Trade-Offs'. Initially, in order to decide the theme, we had a discussion where everyone put forth their suggestions. Even after long hours of heated debating, we could not decide one theme. Each topic seemed to have its own pros and cons. However, there was one common thread running through these suggestions: they all involved a trade-off of some kind or the other. We began to appreciate the ubiquity of this basic economic concept and finally agreed to select this as the theme.

Taking the 'In Conversation With' section further, we have interviewed three eminent economists this time- Lord Meghnad Desai, Rajat Kathuria and E. Somanathan. Talking to them gave us an insight into how the world truly functions and helped us to somewhat bridge the gap between textbook leaning and practical application of economics.

Continuing with 'Buzzwords of the Year', the topic this year is the much talked about depreciation of the rupee. The rupee crash to an all time low of Rs 68.80/dollar in 2013 made headlines for a substantial part of the year, and hence it was inevitable that this would be the topic for Buzzwords. 'Thinking Seeds' this time attempts to explain basic economic concepts such as inflation, consumer awareness etc.

This year, we also started with a new initiative in the form of an economics discussion group called 'Vishleshan' (meaning 'analysis'). We have had discussions with Dr Rohit Azad, a professor at the Jawaharlal Nehru University, Mr Subramanium Swamy, senior political leader and Dr Arvind Virmani, Indian representative to the International Monetary Fund. Here, we present a small glimpse of the three enlightening sessions. Additionally, we also had two lectures under the aegis of the Alumni Lecture Series entitled "Understanding 'India' Sustainably: the Economics and Politics of

Resources". The first was by Ms Nandita Mongia, former professor at Miranda House and currently an adviser to the National Clean Energy Fund. The second was by Ms Amita Baviskar, an ex-student at the Economics Department of Miranda House, and currently an associate professor at the Institute of Economic Growth. The journal also takes a quick look at these.

Reflecting the content of the magazine, the cover page is an amalgamation of several economic issues which we currently face, ranging from currency depreciation, high unemployment, runaway inflation, the debt crisis and the plight of the common man today. These have been rendered beautifully on canvas by Ruby Mittal, our budding artist-cum-economist.

Finally, the editorial board has been extremely efficient and supportive throughout. Our journey has been a very pleasant one and we have learnt a lot along the way. We hope that you readers enjoy reading Aapoorti as much as we enjoyed compiling it.

Regards,

Aditi Singh
Deeksha Trehan
(Chief Editors)
Aapoorti

Note: We assume full responsibility for any remaining errors. Also, please note that the institution has been mentioned for authors who are not of Miranda House. The rest should be supposed to be from the Economics Department, Miranda House.

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INDIANOMICS

Can India Experience Economic Reform Without Political Revolution?

Stuti Oberoi
III Year

Since independence, India has seen a few strokes of economic reforms, the 1991 reforms being the most prominent ones. However, today with a slow real gross domestic product (GDP) growth and a high inflation rate, the country seems to be operating at full capacity with a sense of saturation. There is a general discontentment with the political and economic system among the citizens of India, and an unwillingness to cooperate with the government. With a fickle federal government and the regional parties gaining more power, key economic reforms are stuck in messy politics. This is accompanied by innumerable corruption charges, low economic growth and investment, and high inflation. All these stress an urgent need for another round of economic reforms that must be backed by a political revolution.

The growth rate of the Indian economy has been dwindling, with 4.4% in the first quarter (Q1, April-June) of the current fiscal year 2013-14. Inflation rate has been on a rising trend (6.6%, September 2013), with food inflation between 15% and 25%. The marginal efforts targeting industrial growth, monsoon-dependent agricultural growth, and the drop in private consumption are only worsening the situation. Although the situation is not as bad as that in 1991, we cannot wait for such a doom to bring about a change.

There is a dire need for another dose of economic reforms in order to revive India's growth potential. The biggest challenge that India faces today is its infrastructure deficit. Reform is much needed in the markets for inputs like power, labour, capital, and land. The reforms of 1991 that liberated the product market left the factor market for these basic inputs out of their purview, and they are still under state influence. According to a report by the consulting firm McKinsey, India is short of $190 billion in the infrastructure sector and is in urgent need of capital. 2% of road length carries 40% of all road traffic of the country. Due to the fragmented nature of the industry, road transport services in India are poor with high logistical costs. For India to grow at 8-10% a year, electricity supply must double in a decade, which is difficult because, even though the government has sought private investment in power stations, the supply chain is still largely unreformed. Fuel (mainly coal in India) is dug up by the state, which does not have enough funds to raise its production fast enough. The generation and distribution of power by the state at less than the market price has led to major losses in the GDP. With the Indian population growing at phenomenal rates,

there is a need to create around 12 million jobs per year for the next two decades. Many of the people entering the workforce are unskilled and from the poorest regions, placing a demand for better education and transport infrastructure.

Reforms in Foreign Direct Investment (FDI) rules are much needed, especially in the retail sector, which is one of the largest employing industries in the country. There has been slow growth in this sector due to inefficient and outdated technology and poor organisational structure. It is largely controlled by small-scale operations due to which Indian suppliers have not been able to deliver to the consumers. According to Indian Commerce Minister Anand Sharma, 30% of agricultural produce does not reach the market, and 50% of the remaining 70% is lost due to poor transportation and storage technology. This is a gross waste in a developing country with millions below the poverty line. This inefficiency due to lack of organisation is the root of India's problems. Increasing the cap on FDI in the retail sector will allow foreign firms to enter the country and make major investments, setting the country on a path towards further modernisation, and help it to increase consumer spending and address food inflation.

Bureaucracy has been scaring foreign investors away. The heads and chief executives of India's most prestigious firms have expressed their frustration and state that they have lost the will to cooperate with India's corruption-laden government. Indian firms themselves seem to be in favour of investing abroad than at home, in areas that may project the weaknesses of the nation, such as importing more expensive natural resources like coal despite having the fifth-largest reserves in the world, owing to a lack of infrastructure to tap them. Capital expenditure has been slowing sharply and a further dip may hurt both short-term and long-term growth figures as well as the economy's capacity, which will have an adverse impact on investor confidence and this might turn into a vicious cycle. Like other emerging economies, India needs to build up a structural setup that ensures a long-term growth trajectory in order to ensure investor confidence.

All of India's economic woes can be traced back to the Indian political system. The economic slowdown has been partly attributed to domestic issues like pressures of democratic politics. There is a political crisis with a paralytic central government. At present, the ruling party is holding together a coalition of smaller parties to form a majority in the parliament, called the UPA. In its current form, it is weak and fragmented, and the parliament, due to lack of a clear majority, is losing power to regional parties that threaten to pull support over major reform issues as they are more interested in short-term consequences. The opposition party, BJP, has been more committed to unfolding the weaknesses of the Congress rather than working towards finding solutions. In 2012, Pranab Mukherjee (Finance Minister at that time) stated, "Coalition politics and federal considerations played their roles in holding up economic reforms on several fronts, ranging from diesel and LPG pricing to FDI in retail". Although bills on tax reform, subsidy reduction, and FDI reform exist (with a recent enforcement of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 after deliberations lasting for 2 years), but a divided parliament is unable to pass the bills. There are long delays in political decisions and deliberation of bills that accrue to important policy decisions with far-

reaching economic outcomes, such as a new sales tax (Goods and Services Tax). In the current system of taxation, it is difficult for businesses and investors to run operations across the states due to the differing tax regulations. There is a desperate need for reform of tax laws in India. If passed, the reform bills will bear fruit in a very short time, fuelling business and inducing confidence.

India's position regarding the fiscal budget is grim. The government has been spending on fuel and fertiliser subsidies programmes, which has been possible in the recent past due to GDP growth averaging around 8%. But now, with dwindling growth rates, there is a need to curtail spending, discontinue these subsidies, and divert the funds to other sectors. The government's efforts in this area have not been fruitful due to opposition from regional parties. Using tactics like 'All-India Bandhs' against the government's efforts to repeal the subsidies, regional parties have become a hindrance for any reform. Even FDI in the retail sector has seen the same fate, with Mamata Banerjee, Chief Minister of West Bengal and an important UPA ally, pulling the plug and ending support.

The Indian democratic process makes enforcement of sustainable policy reforms more difficult due to powerful opposition from interest groups. Examples include farmers against the loss of subsidies, and protected industries fearing foreign competition. Politicians do not prefer to cause unrest among powerful interests, which are the source of funds for all their political activities and personal bank accounts. They are disinclined to foment conflict with public-sector unions over privatisation or tax reforms. Elected politicians are extremely short-sighted, their vision lasting only till the next elections. The quality of Indian politicians has decreased and many of them are out of sync with modern day realities. Most of them are corrupt, and disinterested in serious reform. The increasing number of politicians with criminal records and the use of bribes to get party tickets and vote banks completely erode India's democracy. Historian Ramachandra Guha wrote recently, "There are allegedly 'democratic' politicians who abuse their oath of office and work only to enrich themselves; as well as self-described 'revolutionaries' who seek to settle arguments by the point of the gun". Only serious electoral reform can ensure a better breed of politicians.

Scams delegitimise state action. Thus, growth-sustaining reforms include cleaning up political funding and combating corruption. Institutional reform to expand and cleanse the judiciary, speed up prosecution and reform political funding are pro-growth steps that need to be taken immediately. A political reform that has often been suggested is to publically mandate intra-party elections at all levels in all recognised parties and maintain a public register of their memberships. It is ironic that the world's largest democracy runs its party system in an almost feudal manner, making any kind of change extremely difficult because a paternalistic approval is needed from the old leaders and new leaders can hardly ever challenge them with a bold vision.

Base politics induces a degree of financial non-viability by providing goods and services that are not paid for, such as power theft and giveaways. If the state government pays for the power it demands, even for giving away to farmers and entrepreneurs, power will turn into a commercially viable sector and people will start investing in it. Appointing ministers for telecom and roads might lead to concentrated efforts in these areas in order to generate visible results,

rather than simply pocketing money from these sectors. But resolving such issues is essentially a question of political will.

Another area where a political revolution must precede economic reforms is governance of states that underperform with respect to their potential. For instance, Bihar has the potential of becoming the largest producer of sugar in the country due its agro-climatic features that are ideal for sugarcane, which can even survive an occasional flood. But sugarcane needs to be crushed right after being harvested and this requires the presence of sugar mills in the vicinity of the field. These sugar mills are largely under the state government, leaving them at the mercy of protection racketeers and corrupt officials with no personal motive to bring up more mills. Though reforms may be initiated by the national government, state governments play a decisive role in implementation and must be made more accountable.

Reforms are more likely to be sustainable the more institutionally embedded they are and the less they depend on any particular individual. They need to be comprehensive enough to not be sabotaged by the unreformed sectors of the economy. Hence, implementation is extremely critical. Because reforms need long time horizons, the politicians in power need to realise the need to take some bold steps for future benefits, moving past the trivialities of gaining power in the next elections.

Economic growth in the country has occurred mainly due to the dynamism of the private sector, in spite of a corrupt government, As stated by Vijay Kelkar, policymaker and chairman of the 13th Finance Commission, India needs a reform stimulus than a fiscal stimulus, and the most pressing economic reforms are squarely in the realm of politics. Any kind of economic reform now needs to be preceded by a political revolution, in order to provide the institutional structure needed for the reform to be sustainable.

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Excavating India's tourism potential

Ratanpriya Agarwal
II Year

Indian economists are trying their best to solve the BOP crisis. While they are looking for methods to attract foreign income, they have overlooked the enormous tourism potential our country holds. France, in the year 2012, had 83 million foreign tourists while USA had 67 million foreign tourists. India had only 6.6 million foreign nationals, out of which a good percentage were NRIs visiting their relatives. India has a history that predates those of European nations. We have artefacts that show great advances in human intelligence and a treasure of natural resources as well. The problem is that we are not able to market as well as develop our resources in a way that attracts tourism.

We just use our natural resources for industrial development. Our lakes and rivers simply serve as drains for industrial waste. We need to rejuvenate our resources, and make them ideal for a paradise-like holiday experience in the lap of nature, coupled with adventure sports, wildlife safari and other such activities. Infrastructure for the same should not be massive since we don't want to disturb ecology. Rather, we should involve the local populace, who will find a new source of livelihood and thus have a vested interest in safeguarding the resources as well.

India has 30 UNESCO World Heritage Sites, with another 30 in the waitlist. UK has only 28, with tenfold number of tourists visiting them. Why? Because we lack investments in tourism infrastructure — roads and other forms of connectivity, tourism police, financial services, hotels etc. Tourist sites lack basic amenities and are situated in the middle of cities. They are places which stubbornly display all negative attributes of a problematic tour, proving the shallowness of the promise of the Government of India to provide royal treatment. If we want foreign visitors to experience India's cultural heritage, we need to maintain, restore and renovate our historic monuments. To accomplish this, government agencies should work diligently with private players, and more importantly, we should be proud of our architectural heritage and not ruin it ourselves. Indian citizens are also irresponsible and their behaviour is far from the principle of '*atithi devo bhava*'.

Another issue is that globetrotter is undercharged for sightseeing in India. The entry fee for an alien traveller at Ajanta caves is only Rs 250, which is even less than $5. An international tourist, who has spent about a thousand dollars to visit a country, will certainly be willing to give more than what he/she spends on a chocolate sundae.

In the globalized world, technology and skyscrapers are not the only things that attract tourists; it is the distinct culture and traditions which catch their attention. Millions participate in La Tomatina in Spain

and La Carnaval in Brazil. India offers a potpourri of different cultures and traditions. We have a long list of unique festivals, which display our diversity and beliefs. India has an array of dance, food, music, lifestyle etc. What we need is extensive cultural marketing which will generate a perspective that visiting India is a unique learning experience which maximizes the value of leisure time. With increasing popularity of yoga in the contemporary world, and India being a birthplace of major religions, India has a spiritual atmosphere. Religion governs lifestyle here and tourism due to religious belief is a major source of domestic tourism. With appropriate policies, India can emerge as the yoga and spiritual capital of world. It's already the fastest growing wellness tourist destination. Westerners flock to India for life changing trips to visit meditation retreats and spiritual centres. Wellness travel represents 14 percent of all tourism spending. It's estimated to have an economic impact worth a million dollars.

Falling rupee has made India an affordable and attractive tourist destination. Increase in international demand for Indian ethnic wear and jewellery can also play a critical role in promoting tourism. With reduced costs, the availability of latest medical technology and growing compliance with international quality standards, medical tourism is a rapidly growing sector in India. It is expected to experience an annual growth rate of 30%, making it a $2 billion industry by 2015. Advantage of a devalued currency can be extended to other sectors of tourism also.

Availability of skilled manpower is a major challenge faced by the travel and tourism industry, one of the largest employment generators in the country. To sustain growth in this industry, trained workforce is required at every level, but due to poor supply, the industry has no alternative but to fill the void with untrained resources. Such a high proportion of untrained manpower would adversely affect the quality of services offered to tourists.

Although India is a storehouse of rich tourist locations, yet it figures near the bottom. The Travel & Tourism Competitiveness Report 2013 ranks India at 65th spot out of 144 countries. Marketing and promotion of India as a major tourist destination is critical for the industry to achieve its potential. Lack of adequate budgetary support for promotion and marketing, compared to competing tourist destinations, is a major reason for India lagging behind as a tourist destination. To use tourism as an engine of growth, we need innovative and creative marketing strategies designed specifically for different sections of visitors. Gujarat started the '*Khushboo Gujarat Ki'* campaign and roped in Amitabh Bachchan as its ambassador, which increased the state's tourism revenue by 14 per cent per annum. This rate is twice that of the national growth rate of 6.7 per cent! The tourism ministry needs to create a new campaign to increase tourist inflows into the country. The 'Incredible India' campaign, which started in 2002, has lived its life and needs to be reinvented.

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Deadly Contract

Robinson Buriuly
II Year
Ramjas College

It was during the period of my research on sewer workers in Delhi that I first woke up to the irony and incongruity of the slogan of 'Nirmal Bharat Abhiyan' rolled out by our government. It is the class of these contractual sewer workers, who despite all the harassment and daily struggles of life, continuously strive to solve the sewage problems in the city. Commonly known as 'beldars', these contractual workers work for the Delhi Jal Board (DJB) without identification and also without the requisite identification cards. The rationale behind DJB and contractors not providing identification cards is that it prevents them from being accountable for any possible death or health hazard.

As I moved ahead with my survey, I found out that the beldars work on contract basis for several years, awaiting permanent jobs, which remain a farfetched dream for them. They are deprived of health benefits, despite the fact that they work in highly toxic circumstances. Even in the event of death, no compensation is received from the contractor (whom they go on without seeing for years) or from the government. Without any safety equipment, they not only face the debilitating reality of cleaning up human waste, but are also viewed with contempt and disdain when they act on complaints of sewer jam in our neighbourhoods. They are deprived of basic equipments like litmus paper to check the toxicity of gases in sewer which is a major cause for deaths and health problems.

Apart from these, there were other much more disturbing facts that I came across, such as no provision of soaps and washrooms to take a bath in after they finish with their work. They are thus forced to walk about with the stench of sewer on them.

Most of these workers belong to the Valmiki community, of which a majority has reported problems with their eyes and skin. The test results of their lungpower and weight signalled a plethora of health problems. Also, no facility for conveyance to work leaves them without any savings, as transport facilities are expensive and they work on a meagre salary. Even though permanent sewer workers do get a salary which is three times their contractual counterparts, their predicament is no better. They have access to security equipments, but either they are faulty or at times better left in store rooms. These permanent health workers are made to undertake departmental health check-ups every six months, where each time their health reports turn out to be fine. However,, ironically, when they arrive at private clinics, they are diagnosed with various medical ailments. They shell out their salary in these clinics and no reimbursement is provided against the private treatment they are forced to undergo. Moreover, they find it difficult to avail medicines at government hospitals. Thus, even though government's antipathy makes a contractual sewer worker worse off, the permanent one is not better off either.

Hence, the need of the hour is to look into the basic needs of the sewer workers, who are the bearers of a city's mission for an efficient and effective sanitation.

Shudh Desi Recipe to Lose Massive Votes

Khushboo Kapoor
III Year
Sri Venkateswara College

NaMo (our famous neta, Narendra Modi) calls our very own naturally taciturn PM as a 'Rupaiya' doctor for putting the Rupee on a ventilator, while the Congress party is on drumrolls after passing two new, economically unsound bills. The two main ingredients of the government's shudh desi recipe to rope in votes include the Food Security Bill and the Land Acquisition Bill. The UPA hopes that these bills will prove to be vote winners in the upcoming general elections of 2014. In fact, these are delusions of grandeur. Ironically, the bills seem more likely to lose than win votes for the Congress.

Firstly, let me ask you a question. Can you think of any new bills that have delivered reasonably well? What?? Still thinking? Despite the Right to Education Act that was passed in 2009 after shifting of tectonic plates in Indian politics, talking about decent education for all even today seems to be a silly joke. Ouch, that may hurt the sentiments of our *netas*! Politicians think that the people cannot understand the strategies employed to gain brownie points during elections, but they forget one thing *"Yeh public sab janti hai!"*

Secondly, there is a trade off between microeconomic (personal) gain and macroeconomic gain (welfare of country). Elections are fought on local issues and not on so called national issues. This is also evident in the rising significance of regional parties in the political sphere of the country.

So let me ask, can the new bills lose votes?? Yes, although indirectly. The Food Security bill will cost around Rs 10, 000 crores extra this year (2013-14) and Rs 25,000-35,000 crores next year (2014-15). Whether this amount is 'affordable' or not is a matter of great debate. However, the recent financial crisis has certainly made it more alarming. A crashing rupee threatens high inflation, investment funk and lots of pain. Our finance minister, Mr P Chidambaram, has pledged to shrink fiscal deficit to 4.8% of the GDP. Now think, an extra Rs 10, 000 crores on food security means an equivalent amount less in productive plan investment to control the deficit within this red line.

Even worse is the Land Acquisition bill that mandates a social impact assessment for every project requiring land acquisition, delaying such projects by at least one to two years. Nowadays, there is a sudden rush in the cabinet to show quick dispatching in clearing projects worth lakhs of crores. But reality check!! Many of them require land acquisition clearance.

To foreign investors and rating agencies, India appears to be an epitome of deep structural flaws. In the quest for votes, the government is driving the economy downward. The result may be a downgrade in India's credit rating to junk status. The rupee will fall further, inflation will rise, unemployment will be more severe and income growth will further suffer.

So, the recipe of the party in power presently thrives on keeping people poor,

and the best way to do that is to give away more freebies at the cost of pilfering the nation's treasury. But, sorry! This time sympathy votes won't work as they had after the assassination of Rajiv Gandhi and Indira Gandhi. So it would be better for the party to discard its VOTE! VOTE! VOTE! agenda, as whatever the long-term benefits may be, the new bill threatens to be a major reason for fewer votes for the Congress in the upcoming general elections.

India's Growth Story

Ishita Shukla
III Year

With stories of doom and gloom replacing the hype about India's growth story, and rightly so, it would be pertinent to examine whether India still has a chance to make it big, at least economically.

Economic growth is a necessary, if not a sufficient condition, for being economically powerful. No one will take a country that has more than one-third of its population living in absolute poverty and the remaining facing acute pressure of rising inequality, inflation and huge budget deficits, seriously.

A small detour into economic history is a useful way to get some perspective on these important issues.

The Indian economy continued to stagnate during the last five decades of colonial rule. Economic output barely kept pace with population growth. There were good times too, but the overall story is one of prolonged economic stagnation.

The first structural break came after 1950. It is no coincidence that this was after India gained political independence, and the colonial state was replaced with a developmental state. Economic growth was at least four percentage points higher than it was in the preceding period, no small deal. The Nehruvian economic model of state-led industrialization ran into trouble after initial success. The next period was one among the most difficult phases for the Indian economy. Growth trended downwards, while inflation was high. Many other Asian economies began to reform themselves by the end of the 1960s, while Indira Gandhi preferred to go down the path of radical politics. Many other regional economies began to move ahead during this period.

The second big structural break in the Indian growth story came in 1980, as several econometric studies have shown. In the 34 years since then, Indian economy has expanded at an average rate of 6.89%. Few countries have managed to have such sustained growth over three decades. The growth was sustained over several business cycles, so it is safe to say that it is the sort of growth rate that India can sustain.

The habitual optimists think India can grow substantially faster than it has done since 1980, while the dire pessimists think India is now headed for a far lower growth rate. It is also worth remembering that India right now has a higher savings rate than before, is headed into a demographic sweet spot and is an open economy. The challenges are also well known: the lack of economic reforms since 2004, inadequate infrastructure, a meddlesome state, mediocre job creation, abysmal levels of human development etc.

To the extent that our recent economic history is any guide, it seems that the growth rate that India can sustain is somewhere around 6.5-7% a year. That will help double average income every 14 years, in constant prices. Two extra percentage

points of economic growth will bring down the time frame to double average income to 10 years, a significant change.

Thus, we observe that the economy has slowed down in many ways but it will regain momentum sooner or later, and political confusion is not going to affect the economy except in marginal ways. The economy is certainly going through a bumpy ride, but it is nowhere near the meltdown. India is robust both in economic and political terms.

India's growth story is yet to come!

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Role of Education and Skill Development for Sustainable Development

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The Indian economy is widely expected to grow at sustained high rates over the next few decades and emerge as the second largest economy by 2050. These robust projections have much to do with the demographic profile of the country. India is slated to have one of the youngest populations, with the bulk of it figuring in the working age. However, in order to utilize this 'demographic dividend' effectively, India needs to impart adequate and appropriate skills to its workforce.

Today, the education system in India churns out students that are not immediately employable. Skill upgradation on the job is low, implying that a large section of the currently employed labour force possesses outdated skills. The current skill training setup, comprising of ITIs and polytechnics, caters to only 2.5 million people, which further compounds the demand-supply gap. While 56 percent of higher education institutes are devoted to arts, science, commerce and medicine, engineering, technology and polytechnic colleges comprise ten percent, seven percent and six percent of total institutes respectively. Also, the dominance of general education has prevented the bulk of the population from acquiring skills required by the manufacturing and service industries. Thus, the need of the hour is to analyze the background of vocational education in India and take steps to develop it for vocational education is a means to provide skills to labour force and establishment of human capital.

Background of Vocational Education

Defining VET as a sector within the education system poses a number of difficulties as unlike general and academic education, VET develops craftsmanship and practical experience. At the same time, it is difficult to standardize vocational education, as there are certain issues, which hinder a globally acceptable and applicable format of VE.

The analytical issue associated with it is that the etymology of vocational education hasn't been constant over the ages. During the Industrial Revolution, 'vocational' referred to the type of education that aimed at stable job and stable career in a

respectable profession. However, in the 20th century vocational is seen to be at the bottom of a hierarchy of knowledge and value and is seen as a stream of learning available to the "lower achiever".

In India, the political issue is that vocational training is handled by multiple ministries, without the required level of coordination between them. Thus, there exists conflicting means and methods towards VET objective. This makes a standard implementation of VET a distant dream. Before proceeding further it is required that we comment on the state of the labour market in India

According to the Economic Survey Report of 2007-08, 64.8% of India's population would be in the working age of 15-64 years in 2026 up from 62.9% in 2006. It has also been noted that statistics point to a significant share of incremental demand occurring for skilled labour and vocationally trained people. However, it is estimated that India is likely to witness a deficit of 5.25 million employable graduates and vocationally trained workforce by the end of this year. Industry sectors like retail, textile and apparel will require about 90 percent of its recruits to be vocationally trained. Similarly, hospitality and healthcare will add additional 6 million to the current labour demand by 2013. With an average market size estimated at US$100 billion, the demand side looks bright for skilled labour, especially those with vocational training.

On the supply-side, the size of the current technical training infrastructure is much smaller than what is required. India currently has the capacity for training 3.1 million people per year. This is insufficient, given that every year, 12.8 million new people enter the workforce, of which only a quarter receive formal education and training. Thus, we have a supply-demand gap created by institutional factors and persisting social infrastructure like education.

Relation between public expenditure on education and returns to growth

In the neoclassical growth model, the economy is "assumed" to reach a steady state when all macroeconomic variables grow at the same rate, and in the absence of technological progress, the per capita growth of these variables will eventually cease.

In 1986, Romer pioneered a new explanation wherein long-run growth was determined by endogenous factors. This explanation of growth pattern witnessed interest among the researchers understanding the linkages between fiscal policies and economic growth. Most of the empirical work on measuring returns on education expenditure on growth uses years of schooling, government capital expenditure as the explanatory variables to determine the value of dependent variable GDP over time-series data.

There are three fundamental ways in which education affects employment. Firstly, those with fewer skills, less practical knowledge and lower level of education are less attractive to potential employers. Secondly, individuals who pursue technical or vocational education will enter different occupation than those emerging from the general education system. This creates a certain dichotomy in terms of market signalling by a prospective employee to the employer. The third effect is routed through the quality of education that will determine the mobility of an employee in an organization once recruited.

Now that we have established the relation

between the labour and education market, what is required is that we look at the steps taken by the Indian government to enhance education in India. The eleventh 5-year plan, touted as the "education" plan, involved a number of issues relating to higher education. The University Grants Commission prepared a blueprint for future strategy and the main focus was expansion of higher education at the national and state level through higher enrolment, equal access to education for all, eliminating all forms of disparity and promoting quality and international excellence in the present educational structure. Expansion in institutional capacity has been reflected in setting up of about 1464 new educational institutions-comprising 30 central universities, 8 IITs, 7 IIMs, 20 NITs, and 20 IIIT's, 3 IISER, 2 Schools of Planning & Architecture, 374 model colleges and 1000 Polytechnics.

Structure of ITI

Industrial Training Institutes (ITIs) come under the purview of Directorate General of Employment and Training (DGET) within the Ministry of Labour and Employment, and hence the responsibility for skill development falls with the DGET.

The policy of setting up ITIs was put forth to achieve the target of developing 500 million skilled people in the country by the year 2022. The emphasis will be on institution-based skill development through polytechnics, ITIs, vocational training centres, apprenticeship-training and training for self-employment and entrepreneurial ventures.

A comparative analysis of private and public ITI structure and conduct revealed that the type of infrastructure required; machines, tools, equipment's, workshops, quality faculty, industrial visits, upgraded technology cannot be accommodated within the meagre earnings from tuition fees which is the glaring factor responsible for the failure of many ITIs in several states.

Also, the course structure is more flexible and favourable in the private-run ITI. Field observations showed that most of the students prefer the private diploma in technical training as they are ready for job within a year. Partnerships with industrial firms and organizations are an important step on the part of the ITIs to avail the best practices for their students. Firms like Volkswagen, Godrej, L&T, Tata Motors and other MNCs collaborate with private institutes like ITIs, and this helps them to avail the latest technology for the students to work with and assure them of apprenticeships as per industry standards. Even on the placement front, government ITI fails to make an effort to partner with firms in getting market standard remuneration for their students. Thus, the private-run ITI is better placed and better poised to cater to the needs of students in industrial training.

However, both public and private ITIs share common limitation as far as sharing of knowledge pool is concerned. Today, sectors such as Information Technology (IT), ITES, construction, electronics, and communication technology complain about the quality of students at the entry level in the labour market. The external labour force comprises of potential employees who lack practical training and shop-floor skill sets. Thus, firms have to invest on the training of their recruits that ranges from 3 weeks to 6 months as per the job requirements. A student opting for the ITI route to higher education will be assured of practical knowledge, technical training plus theory. This puts the student at an advantage over an engineering graduate in

the labour-market. This also saves the firm from expenditure on training at the entry-level. Firms then have the option of investing on skill upgradation and making use of better technology.

Analysis shows that industry-academia collaboration is a successful technique where both the partners have something to gain from the contract. Partnerships with industries improve the standard of technical training in institutes through financial assistance given to them. Through this the institutes equip themselves with the required tools and machines of trade and in return, provide skilled workforce to the industry.

Private sector involvement in vocational training improves the standard of education, as it is more demand-driven. India can adopt the PPP route- collaboration of both public and private in TVET set up. While the government looks after the monitoring and regulation of ITI, private sector will provide the expertise to conduct the programs and deal with employment. We could also incorporate some concepts from international education system, such as of Germany, whose dual education system provides the highest level of flexibility to students and several opportunities. It is one of the best models since it is student-oriented and focuses on an individual's strengths, interests and likes in any field.

The Future Road-Map

The Indian higher education system is outdated. Graduates find it difficult to get placed- the demand side does not react to the supply because the labour lacks practical skills and "hands-on" training. Companies refrain from training employees to maintain their bottom lines. So the responsibility to make the working-age population an asset for the economy rests on the education sector. This calls for greater public spending (investment) on education as a part of social infrastructure. Theory shows the effects of fiscal policy on growth. A positive fiscal policy implies higher returns on investment through the Multiplier Mechanism. This task involves deeper observation of student's perception of the education system and increase in private participation.

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Privatisation in the Banking Sector

Vasundhara Krishna
III Year

Reserve Bank of India governor Raghuram Rajan has declared that he intends to launch on a "dramatic remaking" of Indian banking. In fact, the case for a 'remake' had been made as far back as 2009 through the Committee on Financial Sector Reforms that he chaired.

It must be noted that there is little innovation in the nature of the remaking Rajan recommends. What is being done and what is planned to be done are all proposals that have been unveiled in the past, by a series of "committees" (from Narasimham I and II, through Tarapore and Mistry, to Rajan)

There has been substantial advance in two areas.

One is the set of measures that give foreign banks greater access to and more freedoms in the domestic banking space. The other is the issue of new private bank licences, for which applications have been entertained from domestic corporations and business groups as well. The latter had been kept out of this space since bank nationalisation. But now, with the committee to examine and decide upon the applications in place, expectations are that one or more business group would re-enter Indian banking. The Rajan machine seems to be working, facilitated by substantial media support, and possibly the fact that the Parliament has hardly functioned and now elections would occupy the nation's political attention.

Public sector banks, on one hand, have been prodded into lending to areas such as the retail sector and infrastructure, resulting in a rising volume of non-performing loans and a growing volume of restructured corporate debt. While restructuring has helped conceal the extent of implicit default and dress up the financial accounts of banks, even the RBI's recently released report on trends in banking expresses concern about the state of public bank balance sheets.

On the other, the RBI and the government appear committed to ensuring that Indian banks meet the increasingly stringent capital adequacy requirements set by the reformed Basel guidelines. There are three consequences flowing from this commitment.

First, since the early 2000s, the government has been forced to infuse capital into the public banking system to strengthen their balance sheets and bring them into conformity of globally recommended standards. As the accompanying chart shows, the government has thus far infused Rs.743 billion into the public banking system, with much of it having been

provided since 2010. But even this is far short of estimates of what the banks would require if Basel III has to be complied with. One estimate places the requirement at Rs.5000 billion over the next five years.

Second, with the government still looking to the banks to provide the credit that would finance private investment (in areas varying from housing to power) and consumption (of automobiles and much else), non-performing loans are bound to increase. Hence, expectations are that the sums required for recapitalising the increasingly weak bank balance sheets would increase.

Third, since the start of the process of recapitalisation, the kind of capital required to beef up the capital on bank balance sheets has changed. Increasingly what is required is tangible common equity capital. If this has to be ensured while keeping the government's equity holding in public banks constant, much public resources would be required. D. Subbarao, an erstwhile governor of the RBI, had estimated that the government, which owns 70 percent of the banking system, will have to pump in Rs. 90,000 crore equity to retain its shareholding in the Public Sector Banks (PSBs) at the current level to meet the norms. It must then provide resources in the budget to buy into equity, with attendant implications for expenditures. If revenue increases cannot finance those expenditures, the fiscal deficit will widen, which goes against the self-imposed targets of the government. This has set off a demand that public sector banks should sell new shares in the open market to finance recapitalisation. But there could be one problem. Current law requires that the government should hold at least 51 per cent equity in public sector banks. A case is being made that reducing public shareholding from current levels to 51 per cent will not yield adequate capital for recapitalisation that permits realisation of Basel III standards. Subbarao, for instance, is reported to have argued that "fiscal constraints pose significant challenges" to the efforts to re-capitalise banks and to ensure that they meet Basel III norms, but bringing down government holding to below 51 per cent can resolve the problem. The case for recapitalisation has been converted into a case for privatisation.

Thus, the call for privatising public banks also predates Rajan. The Narasimham Committee on Banking Sector Reforms had, as far back as 1998, called for a reduction of the government holding in 'public' banks to 33 per cent to make them more dynamic. The Percy Mistry Committee had gone further to argue that privatisation is needed because state-ownership had adversely affected the quality of financial intermediation. The only change now is that the case is being built on the grounds that privatisation is needed to ensure capital adequacy.

Thus, implementing this feature of the financial reform agenda is more difficult, since it requires changing the law, which in turn, needs political support that might be difficult to garner.

Financial Inclusion- Panacea for Poverty Reduction in India

Debasmita Padhi
II Year

"The test of our progress is not whether we add more to the abundance of those who have much; it is whether we provide enough for those who have too little."

- Franklin D. Roosevelt

Background

Poverty reduction has been an important goal of development policy since the inception of planning in India. However, a sizeable section of the population, particularly the vulnerable groups, such as weaker sections and low income groups, continue to remain excluded from even the most basic opportunities and services provided by the financial sector. Despite being one of the ten fastest growing economies of the world, India is still home to one-third of the world's poor. The Five Year Plan puts emphasis on adopting 'inclusive growth' as a strategy for poverty reduction. Therefore, ensuring access to financial services which include the entire gamut of savings, credit, insurance, remittance, etc to the excluded majority assumes significance in the Indian context.

The nationalisation of banks in India took place in the year 1969 with the focus on the social responsibility of banks in providing financial services to the poor and needy. Today, there are more than one lakh branches of scheduled commercial branches in India. But how many people actually have access to banking services? It is evident from the World Bank Findex Survey (2012) that the majority of the rural population, particularly in the rural areas, still remain excluded from the purview of banking facilities present in the country. As put so aptly by Amartya Sen, poverty is not merely insufficient income, it is, inter alia, the absence of the ability of the large numbers of poor - the 'bottom of the pyramid' - to participate in economic and political systems.

Present Scenario

The reason for lack of access to financial services by the majority of households could be several. Absence of banking network in proportion to number of household and lack of financial literacy among the poor may be the most prominent reasons among them. Head count ratio of poverty is inversely proportional to the index of financial inclusion - Example, among SAARC nations, Sri Lanka has the high(est) FI Index and hence its head count ratio of poverty is the least. To broaden the scope of the formal financial sector in India, the Committee on Financial Inclusion under the chairmanship of Dr. C.Rangarajan had recommended setting up of two funds - Financial Inclusion Fund (FIF) and Financial Inclusion Technology Fund (FITF). The two funds have been established with NABARD, which is the coordinating agency of the financial inclusion initiative, with respect to creating awareness as well as providing physical facilities in the form of banking correspondents/facilitators.

Several other efforts have been made too. The Department of Financial Services in the Ministry of Finance, GOI and the Reserve Bank of India, has issued various instructions to financial institutions and banks on the implementation of financial inclusion programmes in India. The rural poor have immense need for banking services. Hence, providing access to financial services need not necessarily be viewed as merely social service, and the potential must be tapped as commercial venture by banks.

Banks are the shopkeepers of financial products and services. A financial product is built on small sums of money, and by purchasing it either from his current income (savings, insurance and remittance) or from his future incomes (loan or credit product), the individual can get large sums of money when he requires it the most. So, design features of a financial product or service are most crucial for a poor person to have access to them. Banks, on the other hand,

appear justified to some extent to look at the seemingly prohibitive cost of providing such facilities to these sections. Where population is low the cost of setting up a branch would have far outweighed the expected returns at least in the short run.

Issues and Challenges

The constraints need to be addressed and understood from either side to get to the bottom of this paradoxical mismatch between the demand and supply sides. Like the monsoons in India, the earnings from the agricultural sector are also erratic. Manual labour is migratory and irregular in nature. Households in the subsistence economy depend on friends, family or usurious moneylenders to meet financial exigencies. They have no access to services that suit their needs, are suspicious of the corrupt babus in banks and red-tapism and end up using informal methods that trap them in the vicious cycle of poverty. Their necessities can be outlined as follows- ease of access, security and safety of deposits, low transaction costs, convenient operating time, minimum paper work, ability to transact easily and frequently, avail quick and easy access to credit and other products including remittances suitable to their income streams and consumption patterns. To say the minimum, they need easy loans and deposit-withdrawal facilities. The banks on the other hand, expect returns commensurate with the cost of providing such facilities to these sections.

This is where the role of group financing and Business Correspondents/Facilitators emerge. Group financing by banks is intended to minimize transaction costs to both the clients and the banks.

Turning to the dynamics of the process of financial inclusion, a two phase plan was put into action. In the first phase, banks were advised to draw up a roadmap for providing banking services in every village having a population of over 2,000 by March 2010 and this target was achieved. In the second phase, Roadmap has been prepared for covering remaining unbanked villages i.e. with population less than 2000 in a time bound manner. About 4,90,000 unbanked villages with less than 2000 population across the country have been identified and allotted to various banks. The idea behind allocating villages to banks was to ensure availability of at least one banking outlet in each village. Branch authorisation has been relaxed to the extent that banks do not require prior permission to open branches even in tier I centres, subject to reporting. To minimise costs, a simple brick and mortar structure has been proposed in unbanked rural centres at a reasonable distance to act as an intermediary between the main base branches and these centres. Banks have been asked to set up their own three-year Financial Inclusion plans to identify goals and meet targets. The first plan (2010-13) threw light on some important roadblocks and the second plan (2013-16) addresses them. With the objective of ensuring greater financial inclusion and increasing the outreach of the banking sector, banks were permitted by RBI in 2006 to use the services of intermediaries in providing financial and banking services through the use of Business Facilitators (BFs) and Business Correspondents (BCs).The focus is to increase the potpourri of services offered so that people can reap the benefits and the volume of transactions ensure that this remains a viable and profitable venture for the banks.

When we talk of minimum paperwork we essentially are referring to the KYC-Know Your Customer norms. These guidelines have been simplified such that small

accounts can be opened without any documentation by just giving a self certification in the presence of bank officials. 'Aadhaar', the unique identification number being issued to all citizens of India, can be used as one of the eligible document for meeting the KYC requirement. Talking of Aadhaar, it is important to emphasise the role that it can play alongside financial inclusion in plugging leakages due to corruption in social welfare schemes. The much debated direct-benefit-transfer will be possible only when the target population has access to banking services. And hence, financial inclusion is the way forward.

Future Strategy

SCRIPT- Savings, Credit, Remittance, Insurance, Pension, Payments transactions is an acronym that condenses the services of banks. The key to successful financial inclusion lies in recognizing the demand for the kind of banking services in the rural sector. Opening of no-frills account, an account that can have "nil" or negligible minimum balance along with ATM/debit card facilities allowing upto four withdrawals per month is the first step in this direction. Some other basic facilities being offered are- pure savings account, ideally a recurring or variable recurring deposit, a remittance product to facilitate EBT and other remittances, and entrepreneurial credit products like a General Purpose Credit Card (GCC) or a Kisan Credit Card (KCC).

Technology has always been the engine of growth. The reach of the mobile phone extends to the remotest villages today and mobile banking can be the way forward. Financial Inclusion has the potential to bring in the unbanked masses into the formal banking system, channelise their savings, stoke their entrepreneurial ambitions by making available credit and thus give a fillip to the economy. The use of Hand Held Devices, Point of Sale machines, micro-ATMs, Banks-on-wheels could be adopted more to achieve the aim of inclusive growth which is needed for the sustainable development of the country.

Financial inclusion is not an option anymore, it is a NECESSITY.

State of Recovery and Raising the Repo Rate

Vasundhara Krishna
III Year

The World Bank and the IMF have held out hopes of a recovery. A growth rebound in the US, signs that the recession has bottomed in Europe, and expectations that growth would revive in developing countries other than China seem to underlie the optimism. But, as the Chief Economist of the World Bank, Kaushik Basu, in an effort to protect the organisation against the likelihood of its projection proving wrong said that they were "cautiously optimistic".
The reasons for this caution are obvious. First, as of now, every significant country of the world is either still in the midst of stagnation or growth deceleration. The 'recovery' is largely because of a minor upturn in a bent, from still low levels. But, as the Financial Times recently noted: "For the past four years, analysts have predicted an imminent acceleration in the US economy, and got it wrong. The mediocre record is growth of 2.5 per cent in 2010, 1.8 per cent in 2011, 2.8 per cent in 2012 and something around 2 per cent in 2013."

The second is that interest rates in Japan the US and the Euro zone are either near zero or extremely low. This implies that monetary policy to stimulate growth, in the form of a reduction in interest rates, has run its course there without much impact. On the other hand, the space for fiscal activism is seen as restricted. Getting a recovery going is, therefore, even more difficult.

Finally, in countries like China and India, besides other emerging markets, the growth slowdown is accompanied by a rise in inflation rates. That makes addressing the slowdown through demand stimulation that much more difficult. India's central bank has just "shocked" markets by raising the policy repo rate by 25 basis points to 8 per cent. This, the third increase in six months, was a declaration that fighting inflation must take precedence over stimulating growth.

Reasons for raising the repo rate

Curbing inflation is the priority: The evidence is clear that across emerging markets central banks are under pressure to raise interest rates despite slowing growth due to rising retail inflation rate.

Preventing the flight of capital from India to developed economies: The gradual reduction in the Federal Reserve's bond purchase policy (following the policy of monetary tightening i.e less money available in the economy) is expected to push up interest rates in the developed countries. This is forcing emerging markets to maintain high and rising interest rates in the hope that they can withstand the hit from developed countries' interest rates, which would suck out capital from emerging markets. This means that when developed economies follow a policy of monetary tightening, it will raise the interest rates in their country, and considering that they are places where investments are safer with very low probability of default, investors may be tempted to take out their money from emerging market economies like India and invest there.

There is evidence about this too. In the week ending January 24, 2014 and the week that followed, emerging country stock indices fell sharply and currencies depreciated because of capital flight, necessitating an emergency response by Argentina and Turkey to stem the fall of the peso and the lira.

Gloomy expectations about emerging markets and deflation in developed economies

Besides the tapering, investor jitters seem linked to the expectation that the world economy is headed for another downslide.

Besides the loss of momentum in China and India, those fears stem also from the threat of deflation in the developed countries. Deflation results in the improvement of production efficiency, due to lowering of the overall price of commodities

Put together these developments and responses, the signal we get is that the world economy is not just still caught in a trough, but that the possibility of the "bottom" of that trough giving way for a further dip is all too real. Seen in that context the recent growth projection exercises by the Bank and the Fund appear to be more a way of talking up markets and persuading governments and central banks to act rather than a confident prediction that the worst is over.

Why SAARC remains Dormant – A Focus on the Hindrances in Indo-Pak Trade Relations

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Even after the formation of SAARC trading bloc in 1985, regional integration among the South Asian countries remains minimal. This article examines the reasons to the same while focusing upon the two largest economies- India and Pakistan.

The classical trade theories imply that the trade should occur only between capital rich developed countries like the U.S. and labour rich developing countries like India. Why then do we see a huge amount of trade occurring between similar resource-rich countries of U.S. and Canada? The line of argument taken up in other theories opposes the one taken by previously mentioned trade theories and implies a contradictory result of greater trade flows between similarly endowed SAARC countries.

Trade potential wherein member states have a comparative advantage in distinct sectors also exists in South Asia. However, for example, India's import complementarity with other members' exports has been low. The presence of large Sensitive Lists is largely quoted as an impediment to growth of intraregional trade flows.

In 1995, the seven South Asian countries – Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka – initiated a multilateral framework for region-wide integration under the South Asian Preferential Trade Agreement (SAPTA). Following SAPTA, the South Asian Free Trade Agreement (SAFTA) commenced in 2006, envisaging a duty free area by 2016 for all Member Countries. However, the success achieved under the treaty has been quite limited

As far as Indo-Pak relations are concerned, historically, the trade flows between the two countries has been highly significant, interrupted by a rapid downturn at the end of 1949. The reason for diminishing India-Pakistan bilateral trade significance is not tariff barriers or quota problems, but informal trade between the two countries, which is generally carried out by (1) rerouting trade through a third country (such as the United Arab Emirates, specifically Dubai) and (2) illegal trade through land borders. Pakistan had promised to grant India the most favoured nation (MFN) status by the beginning of 2013, a status that India had granted Pakistan in 1996. Essentially, this meant that as of 2013, restrictions on imports from India would have to be eliminated which is seen as a positive step towards regional and economic integration. However, with recent untoward incidents at the Line of Control, the process of granting MFN status were put on hold and the informal trade is also expected to rise.

Trade potential – Foregoing gains

Trade flows between the two countries hold immense potential. The gains from trade are studied on an aggregated as well as a disaggregated sectoral level.

Actual-to-potential trade ratio: The ratio of actually realised to potential trade computed on the basis of gravity model. The APT ratio for India's exports to Pakistan is only 0.02, while that for Pakistan's exports to India is still lower, 0.01. Expressed inversely in potential-to-actual trade terms, the potential of formal trade between India and Pakistan is roughly 20 times greater than recorded trade.

Sectoral Gains: Trade is carried out only when there is ~~a~~ net gain to be reaped for the society as a whole, i.e. the gains from trade outweigh the losses from the same. Looking at the sectoral gains and losses arising from Indo-Pak trade, the findings are as follows: First, Pakistan will gain from access to advanced technology and machinery from India. Second, it is likely that the pharmaceutical and automobile industries will lose out to more competitive Indian industries. Third, the agricultural sector could benefit if it is allowed to compete on a level playing field; at present, India's heavily subsidized agriculture makes Pakistani products uncompetitive. Fourth, certain sectors like textiles, electric fans and tyres will gain from trade with India because of its large market as well as Pakistan's geographical proximity to certain regions of India, as compared to some of the Indian states producing these products. Similarly, India stands to gain in sectors like tea, auto parts, light engineering.

Intra-industry trade: Intra-Industry Trade (IIT) within the region which is referred to as the trade that occurs when a country simultaneously imports and exports similar types of products within the same industry or sector. Two sectors - textiles and clothing and automobiles have a high potential for intra-industry and intraregional trade and integration.

Non-tariff barriers (NTBs)

Specific to the case of India-Pakistan trade relations, the non-tariff restrictions are put up at each stage to discourage the movement of goods across borders. There is also an allegation that some NTBs are levied by India only against goods from Pakistan in an ad hoc manner. These NTBs include lack of proper infrastructure, inefficiencies that persist in the absence of cross-border transport agreements, visa difficulties as well as technical barriers to trade in terms of phyto-sanitary measures. This issue needs to be addressed by developing a system of consistent treatment over a longer time period.

It appears that while there are widely heralded attempts being made to dismantle "official" trade hurdles, other barriers are being added to maintain the status quo, specifically in those sectors where Indian interests are most threatened by Pakistani exporters, such as cement and textiles. The field-level or lower bureaucracy on both sides of the border has been highlighted as a major NTB. Such hindrances and ad hoc behaviour to cross border movement of goods are a result of political tensions between the two countries and the suspicion that the governments and bureaucracy in both countries have for each other

Global value chains

The cross-border production chains in which the raw material extracted in one country may be exported to a second country for processing, then exported again to a manufacturing plant in a third country, which may then export it to a fourth for final consumption are referred to as Global Value Chains (GVCs). The recent phenomenon of the production process being spread across the globe goes a long

way in defining the global trade patterns and becomes an important determinant.

In recent years, the South Asian countries have been showing the greatest growth in GVC participation. For South Asia the upstream links (foreign value added, i.e. the use of foreign inputs in exports) remain very low whereas downstream links (exports that are incorporated in other products and re-exported) are quite significant in GVC participation. This emerges as the consequence because India has a major service led GVC participation which does not use any imports (low upstream links) and countries like Bangladesh and Pakistan produce electronics and automobiles components which are exported to be assimilated in other countries (high downstream links). The working of the GVC then makes it difficult for trade flows between the member nations. Also as most of these GVCs are operated by the big firms of U.S. and Europe, it reiterates the amount of extra-regional trade flows from the South Asian region to these countries. The growing precedence of the GVC in defining trade flows explains the low level of trade between the member countries, for it is the economic power of controllers of GVC which creates trajectories and path dependencies, where the countries get locked in, and to create an alternative regional trade paradigm becomes difficult.

Politics at play

Since trade flows between countries always create some winners and losers, the sectional groups have an influence on the trade relations as they lobby for protection of their interests and pressurise the government to hinder beneficial trade flows. This happens because as consumers, people are not aware of the margin of lower costs of the goods had it been imported but the producers are very well aware that imports have the potential to wipe them off entirely and hence, have more incentive to form lobbies. The other considerations include whether the sector being harmed has a large employment base and if it is so then the flooding of markets with imports will have the potential to decrease the domestic employment as the domestic producers would shrink in size. The employment losses would lead to a loss in aggregate income and a consequent loss in consumption demand which would lead to a vicious cycle resulting in a further fall in income. The overall effect on the economy, then, is an important of consideration of the willingness to trade.

It has been argued that one of the reasons for SAFTA being ineffective is the large Sensitive Lists maintained by member countries. Such items are not offered concessional tariffs. The rationale for any negative or sensitive list in a preferential or free trade agreement is to provide protection to sectors considered unfit for competition (the infant industry argument). However, it has been observed that often, during the process of stakeholder consultation, sectors with strong domestic lobbies seeking protection get included in the list. Sensitive lists, particularly in the case of India have come to be dominated largely by such sectors. According to the tariff liberalisation programme under SAFTA, member countries are required to review the list for reduction every four years or earlier, as established by the SAFTA Ministerial Council (SMC) but there is no formal or binding commitment. Hence, the reduction of sensitive lists becomes a voluntary decision by each member country which is in turn decided upon by the degree of influence of such interest group lobbies.

Hence, it becomes imperative to take into account the interplay of the various factors

that hinder trade between the SAARC countries and go beyond formal trade relations.

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THINKING SEEDS

Economics to the Layman

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In India, on an average, all students compulsorily study economics upto class tenth (in the CBSE curriculum at least). Despite this, medicine and engineering remain the top notch professions taken up by maximum number of students thereafter. Why is it so? It is because these professions apparently mint money (or so it is perceived), which is in sharp contrast to the not-so-lucrative economic profession. Therefore, not surprisingly, only a small section of the population is actually interested in understanding the dynamics of money and how it works.

Wikipedia describes 'Economics' as the social science that analyzes the production, distribution, and consumption of goods and services. The term economics comes from the Ancient Greek words οἶκος (oikos, "house") and νόμος (nomos, "custom" or "law"), hence "rules of the household." It is obviously not restricted to one household, but a set of households that comprise the society and thus a country and then ultimately the entire world.

Economics, replete with complex and pensive words and definitions, is a holistic approach towards the betterment or welfare of every individual. It analyses problems from the root level and postulates theories and ideas in order to get rid of unwanted economic problems. In cases where they are inevitable, the science suggests measures to reduce the harm to minimum.

Economics, in a broader sense, covers all aspects of an active human life whose fate has been dictated by money for quite some time now. The economy, which is the subject matter or crux of economics, is further subdivided into different sectors, depending upon the products or services produced. When we talk about money, credit cannot be too far as not everyone is always self-sufficient. Consumption is bound to exceed expenditure sometimes, and that's when credit comes to the rescue. Loans, collateral and other important credit terms are often well known to the educated. But it is the illiterate who remain ignorant and are easily deceived by the moneylenders. However, the emergence of self-help groups has given them the confidence to dream big and fulfil their dreams too, without any large monetary pressures.

Economics also deals with consumers and is replete with theories concerning consumer welfare and utility. Each one of us is a consumer of a multitude of things and it is essential that we be made aware of our

consumer rights. Concerns regarding frauds against consumers have led to the formation of consumer forums. Producers are consumers too. Therefore, they should be especially sensitive and well-informed about the duties and responsibilities they have towards the society and its beings. Furthermore, information is power in economics as it keeps businesses updated about the new variations and revolutions in the market. One such example is that of globalisation. Ever since the market was opened to the world, many companies failed to survive the competition. Few of them, however, did sail the tides and emerged with flying colours. It exposed the country to new genres and the best of ideas and technology all over the world. Economics helps organisations produce goods and services in a way that maximises profits.

Last, but not the least, economics talks about development, or more specifically, sustainable development. It is all inclusive development that propagates the need for preservation of resources by not overexploiting them indiscriminately. Economics uses an inter-disciplinary approach too. It relies on history to help it learn from past mistakes and on political science to think about how, when and where it is best to materialise business ideas. Development is measured by indicators like the Human Development Index that take into account factors such as per capita income, literacy rate, health. However, abstract values like equality, respect and sense of security, though they are not given a high economic value currently, play an important role in any society and research is going on to find ways to incorporate them.

I feel that economics as a discipline is incomprehensible to an average man. I too had to brush up my constricted knowledge of the subject to pen this down.

Come to think of it, if economics, with all its assumptions and theories, is a compulsory subject in all streams of education, then it must be greatly required for our future.

I am a Smart Consumer

Ishaan Sethi
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Today's Indian consumer faces a bewildering array of choices for practically any product or service. But the options are so many that it confuses us to an extent that many of us are not sure how to choose the right product. In such a scenario, what type of a consumer would an individual want to be? The answer to that would be ‘a smart one’.

Being a smart consumer means deciding and spending wisely to get the most out of what is spent. It means maximizing your satisfaction at the minimum cost. A smart consumer can promote his well being by safeguarding his consumer rights.

Therefore, being a smart consumer is highly important, and indeed, I am a smart consumer.

I ask myself before every purchase, do I really need it or do I merely want it? Needs and wants are core concepts in marketing, and the producers know exactly how to blur the line between the two. But as a smart consumer, I am able to draw a clear unseen line between needs and wants. In other words, I'm able to differentiate between a luxury and a necessity. And I maintain low

prices by making demand elastic to price fluctuations and by switching over to substitutes whenever I feel the need to do so. I do not get carried away by advertisements and their misleading extravagances which do not reflect the real quality and purpose of the product.

I am well versed in all consumer protection laws. I am not an easy target in the consumer market, nor am I a naive consumer who buys everything that is for sale. I am aware of the competitive structure of consumer markets, where there cannot be any price discrimination. I am conscious of the ingredients or parts used in the products I purchase, and I carefully refer to the product information and instructions.

Finally, I have a strict upper limit on my expenditure, and a major part of my income is devoted to savings. I keep myself fully informed about the ongoing interest rates and carefully manage my portfolio decisions. My consumption today must compromise with my needs in the future and I must constantly strike a balance between the two. Having said that, I also know that a higher quality, more expensive product will last longer, saving me money in the long run, but that does not mean shelling out hundreds or thousands of rupees for any commodity.

I believe in the empowerment of consumers all over India.

Inflation

Aayushi Verma
I Year

Inflation refers to a persistent rise in the general price level of goods and services in an economy over a period of time. Consequently, it reflects erosion in the purchasing power of money or a fall in the value of real income. A chief measure of price inflation rate would be the annualized percentage change in the general price index (normally the consumer price index) over time. Inflation's effects on an economy can be positive or negative concurrently. The negative effects of inflation include a decrease in the real value of money, bonds and other monetary stocks over time. High inflation leads to a shortage of goods as consumers begin hoarding out of concern that prices will increase in the future. Positive effects include increased ability of the central banks to adjust nominal interest rates as well as incentives for investment in non-monetary capital projects.

Since the last decade, India has been increasingly identified one of the fastest growing emerging economies. It has advanced in every field, be it industrialization or satellite launching. However, these are just appearances, and as they say, “all that glitters is not gold”. In keeping with the above statement, if we really want to look at the true picture of our nation and understand what is going on in every nook and corner of our country, we need to go visit and look at the ground realities of every town, district and city which constitutes India. India is not only replete with corruption, selfishness in every soul, and illiteracy, but also with poverty. Poverty does not enter people’s lives on its own; it is the rise in prices that makes them a prey to this curse. The prices of basic commodities have increased exorbitantly. Due to this, poor people find it increasingly difficult to get a loaf of bread to fill their stomach twice a day. This is not the life they dreamt of for themselves, but it is the life that they are given and forced to live in. Aren't they a part of democratic India? Why

does the government not act proactively and consider their problem as a part of the general development process?

According to our finance minister Mr P. Chidambaram, "The hard fact is that there are certain situations like high oil and commodity prices in international market, expenditure on oil, fertilizer and food subsidy that have shot up and on which we do not have control, and so we have to face the consequences." As per his statement, the basic fundamentals of the Indian economy are still strong.

It might be easy for him to say that, but it is difficult for the people who suffer because of it. Poor people can't afford these prices; their lives have become a challenge. If we move around the countryside, we may find their plights overshadowing their happiness. The government should take immediate steps to reduce the prices of commodities and bring about real growth of our economy. When we will start considering villages and their problems as a part of the nation building process, then we would be a country that shall reach the heights of development.

Lifting the Veil: The Informal Economy

Falak Arora
I Year

There are 2 facets of our economy - the formal sector and the informal sector. While much is known about the formal sector, the informal sector is like a hidden chest of lost treasure. It constitutes everything outside the realm of the formal sector. From the private security guards, household help, drivers of cabs, *dabbawalas, presswalas* etc; it includes all who work behind the walls of the formal sector. These people do not have fixed wages but rather work on a contractual basis. They are paid only when there is work. The rest of the time they are left to fend for themselves. They have no job security, or any Diwali bonus, pensions or medical benefits. They rely on sporadic employments.

The term 'informal economy' refers to all economic activities by workers and economic units that are, in law or in practice, not covered or insufficiently covered by formal arrangements. Their activities are not included in the law, which means that they are operating outside the formal reach of the law; or they are not covered in practice, which means that although they are operating within the formal reach of the law, the law is not applied or not enforced on them; or the law discourages compliance because it is inappropriate, burdensome, or imposes excessive costs. The International Labour Organisation describes the informal economy as follows: ''According to a recent report, we are underestimating our GDP by almost 15%. This is because we fail to take into account the growth pioneered by almost half of our workforce falling under the informal sector".

The informal sector makes up for 50% of the economy and its workforce constitutes almost 90% of the total labour force. With such huge numbers, it is surprising how such a ubiquitous sector has been easily sidelined by our politicians. Half of India's $1.85 trillion economy is informal. With 55%, only sub-Saharan Africa has a larger unorganised economy than India's. The reason why our GDP remains underestimated is due to outdated methods for such calculations. Most of the people in the informal sector are self employed and

there isn't adequate data about them. The GDP is underestimated between the ranges of 5% to 15%. For example, in Uttar Pradesh, the informal sector contributes about 65% of the output and about 85% of the non agrarian employment is generated by this sector. UP's economy consists of many small enterprises which constitutes the informal self employment model.

In developed economies, participation in the informal sector is more of a choice and it is done either to avoid paying taxes or to avoid regulations. But in India, it is the result of the failures of our system and government policies.

With this huge section lying outside the formal economy and thus the tax net, the burden ultimately falls on those who are inside it. The tax system in India is one of the heaviest in the world. Tax evasion remains the main attraction of the informal economy. The informal sector does not allow for the proper targeting of government schemes, undermines the rule of the land and hampers competitiveness and ultimately the growth of the economy. The government suffers losses because of this hidden economic activity. The biggest drawback of the informal sector is its inaccessibility to formal credit. Only 18% of credit to small and medium enterprises is formal. This encourages borrowing from money lenders who charge exorbitant rates. This money remains outside the banking system and the RBI doesn't have any control over it. Even revenue of the government, such as TDS, which is deducted from interest rates, finds its escape route.

It is, as if, an avenue for employment for the surplus labour of our country. It is the source of livelihood for almost 85% of the people. Especially after the global financial meltdown, more and more people are finding it to be their safety net. A big downside of being a part of the informal sector is the absence of safeguards such as health benefits, pensions, fixed wages etc. Workers here hence end up saving more and there is less casual spending. Also, the workers do not experience any career advancement, but rather remain stagnant, unable to improve their standard of living. According to the data provided by the Indian government, between 2000 and 2005, the most recent year for which data is available, the number of formal jobs in India stayed flat at about 35 million, while informal jobs grew by 17% to 423 million. The real task at hand is to bring out excellent growth rates. In a country like India, where the population continues to outstrip job creation, people are left with little choice but to enter the informal sector. Even large corporations find workers hired on contractual basis less heavy on their balance sheet than those on full employment basis and hence are, in a way, growing accommodated to such a pattern. The proportion of informal workers in the formal sector has risen over time from 42% of total formal sector to 51% in 2009-10. The incentive for the firms is increased profits and easy escape from labour laws. This further highlights the urgency of proper implementation of labour laws.

An untapped potential of the informal sector is its vast ability to encourage self employment. People who do not have enough capital or find themselves lost in the maze of regulations find it easier to set up their businesses in the informal economy. Not being a registered entity makes it harder for them to protect their intellectual property. Also, while such entrepreneurs create more jobs, they do so in the informal sector. This is another reason why formalisation of the informal economy is all the more important.

Why do people not enter the formal sector?

This is mainly due to the difficult environment under which the formal sector operates, especially in developing countries. The Indian bureaucracy is plagued by red tapism, bribes, excessive taxes etc. The more popular reason is that the benefit of working in the formal sector is available only to the privileged ones. Strict market regulations are another force driving workers against entering the formal sector.

How to formalize the informal sector?

The government needs to bring in changes in different stages. It needs to create new jobs, enough to accommodate the young population. The huge barricades of costs and regulations need to be reduced to make the transition easy. The reason employers prefer hiring on contractual basis is that it is more affordable. Hence, labour laws should be made more flexible. The informal sector attracts many entrepreneurs because of the ease of starting a business, and the same needs to happen in the formal sector. The regulations governing the setting up of a business need to be mellowed down and made more accessible to everyone. It takes 71 days to register a business in India, compared with six in Singapore, and three years to close an insolvent business. The corporate tax code should be more business friendly to keep tax evasion in check and a strong administration brought in for its implementation. More tax amenities and tax based incentives should be introduced. A good example here is that of Spain, which reduced corporate taxes and streamlined labour laws. It managed to reduce unemployment by 40% and increase tax revenue by 75%. Until the informal sector is made less attractive, this web of the gray economy will continue to trap people and the cycle of poverty will consume generations to come!

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The Fascinating Realm of Behavioural Economics

Swaril Dania
II Year

Why is it that we sometimes find ourselves excitedly buying things that we don't really need?

What about the 'FREE' extra helpings that we pile up on the plates at a buffet even though our stomach is full?

Have we not ever bought two of a product that we wouldn't have chosen in the first place just in order to get the third one free?

Trying to analyze one's daily behaviour using the tools of economics often presents various puzzling examples such as those listed above. As we delve a little deeper into these issues, one is introduced to the fascinating world of behavioural economics which tries to provide answers to these amusing puzzles and paradoxes by drawing upon the aspects of both psychology and economics.

But if all economics is meant to be about people's behaviour, then how exactly does behavioural economics differ from the rest of economics? In standard economics, we conceptualize a world of unemotional supermen like utility maximizers and rule out the cognitive and social aspects of human behaviour. And it seems logical to do so, since the models then become practically more relevant and much easier to formulate. But the test of any theory lies largely in its predictive power and crucial to any theory or branch of study are the central assumptions / traits on which the foundation is laid.

Standard economic model has three such traits/assumptions that behavioural economics finds to be flawed.

1. Unbounded rationality
2. Unbounded willpower
3. Unbounded selfishness

The ignorance of bounds on rationality and the limited information processing and problem solving capabilities of human beings in standard economics, often, is the reason why economic agents act in ways that seem irrational and these departures from rationality emerge both in their judgements and choices, and their suboptimal behaviour.

The second idea of unbounded will power is something that seems incredibly incredulous, especially to us, the students, who keep procrastinating till the last day and never manage to submit assignments on time because we, as humans, lack complete self control. The diet plans that fail and the difficulty we have in saving for the rainy day - all are examples of our fallible human behaviour and bounded willpower.

As for the third basic tenet, i.e. people are unboundedly selfish, illustrated in standard economics with the help of issues such as problems of moral hazard and free riding, we have counter examples such as those of altruism and charity that behavioural economics deals with. In fact, several researches in behavioural economics solely deal with the connection between these two separate realms of market and social norms.

Rather than relying on these superhuman traits of standard economics, behavioural economics tends to provide a more realistic, psychological foundation and thus increases the explanatory power of economics.

While standard economics assumes that we independently know what we want and our preferences are fixed and we carry out a rational analysis every time we have to make a choice; behavioural economics, on the other hand, suggests that we are not guided only by rational analysis, rather at times we merely copy others and our actions are a result of social influences and not just any utility maximization process i.e. our preferences are not fixed or independent.

For instance, it is observed when policy makers devise mechanisms with immediate effect such as a fine for over speeding, it has a short term impact which may not last. Knowing that there's a fine for speeding and high likelihood of getting caught, I'll probably drive more slowly, but I will drive just as fast once I realize the chance of being

caught is low. However, if policy makers can change the social norm then much less enforcement will be needed after the change.

Moreover, neo-classical economics fails to recognize the existence of habits. Doing something out of habit such as choosing my normal cup of coffee when shopping, is outside the realm of neo-classical theory, in which I do a full analysis of all the available options. But in behavioural economics, the view that frequency of our past behaviour influences our current behaviour is an accepted norm. Once you pay a certain amount of money for a particular good, chances are high that the next time you buy the same good, the price you'll be willing to pay would be at least the same or more. You wouldn't bother to conduct an independent analysis again for making the choice. This is known as the anchoring effect in behavioural economics. The earlier price acts as an anchor and influences our future actions. The realm of behavioural economics is full of such realistic examples. One puzzling example that clearly highlights the inadequacy of standard economics to explain normal human behaviour is presented below.

''When small fines were imposed on the parents of all children at a day care centre in Israel, if they arrived late, it had a counter effect. Parents arrived late more often than before the fines were introduced.''

This seems illogical in neo-classical economics since a standard neo-classical analysis would add up the financial costs and benefits, so financial rewards would always be expected to encourage and financial fines would always be expected to discourage. But the same example finds explanation in behavioural economics in which it is accepted that we have intrinsic motivations where we do activities for their own inherent reward as well as extrinsic motivations (financial reasons) and example such as that given above show that it is possible that intrinsic motivations are crowded out by extrinsic ones and hence measures such as fines prove to be counterproductive. In the above example, by making a payment, the parents no longer felt guilty about arriving late and treated the situation as if they were paying for a service. Similar behaviour was observed when people were asked to volunteer for some social work. The average volunteering time was 14 hours per week but those who were paid did approximately 4 hours less volunteering work per week than unpaid volunteers.

Professor Dan Ariely presents another interesting example in his book 'Predictably Irrational' about the rationing of tickets for basketball matches at the Duke University Stadium. Since the number of seats available at the stadium is limited, a kind of lottery is used to distribute the tickets among the potential buyers. He asked the winners of the lottery the lowest price at which they would want to sell their tickets to the losers of the lottery and also inquired about the highest price that the losers of the lottery would be prepared to pay for buying the tickets. And the results showed that the average selling price (about $2400) was separated by a factor of 14 from the average buyers offer ($175).

Again, neo-classical economics, that expects people to have a preference on risk (risk loving or risk averse) but usually assumes them to be neutral to loss/gain, fails to explain the difference between someone's "willingness to pay" and their "willingness to sell" i.e. they wouldn't sell something they own for just about the same price as they would be willing to pay to buy it, if they didn't already own it. People are observed to show an 'endowment effect' i.e. once they

own the good, someone's selling price (willingness to accept) for the same good would be upto 20 times the buying price (willingness to pay).

Further, the standard neo-classical assumption of human beings being capable of making complex calculations to compute their optimum best choice with all necessary information at their disposal is a seriously flawed one. Psychologists have long established that people, rather than using any consumer theory, depend upon their internal biases and certain 'rules of thumb' to make decisions. In making a decision between any two actions, if one is presented to us as a loss and the other as a neutral or a gain, we avoid the apparent loss i.e. framing a question differently would yield different responses even if the two outcomes are mathematically identical, such as :

1. Would you agree to undergo a medical procedure if your doctor tells you "Of those who have this procedure, 10% are dead after 5 years"?

2. Would you agree to undergo a medical procedure if your doctor tells you "Of those who have this procedure, 90% are alive after 5 years"?

Positively framing the question leads to more number of people confirming in an affirmative quite predictably but also irrationally since both the outcomes are mathematically identical.

Similar to this is the tendency to jump to conclusions based on our intuitions. An example of a mathematical problem where our intuition is often wrong finds mention in Kanheman's paper.

''A bat and ball cost $1.10 in total. The bat costs $1 more than the ball. What is the cost of the ball?'' Most people answer 10 cents including 50% of Princeton University students, which is wrong. All these are the different kinds of internal biases that may cloud the judgement of rational human beings while making decisions.

Examples such as this and the several ones that have been cited above clearly highlight the need for questioning the inherent irrationality of human behaviour, which is often left unexplained by standard economics. Under the telescope of behavioural economics, one finds that these apparent irrational acts are also systematic in a certain way and hence predictable and learning more about how the human mind ticks, requires that we modify conventional economics and try to have a new understanding of human nature and decision making using the forces of both economic rationality and psychological notions.

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Prepare for Judo Economics!!!

Aditi Singh
III Year

Judo (meaning "gentle way") is a modern martial art created in Japan in 1882 by Jigoro Kano. A central principle of judo is that of *seiryoku zen'yō* (maximum

efficiency, minimum effort), which is illustrated with the concept of *jū yoku gō o seisu* (gentleness controls hardness). According to this concept, resisting a more powerful opponent will result in your defeat, whilst adjusting to and evading your opponent's attack will cause him to lose his balance, his power will be reduced, and you will defeat him. This can apply whatever the relative values of power, thus making it possible for weaker opponents to beat significantly stronger ones.

The term 'judo economics' was first used by economists Judith Gelman and Steven Salop. It is a strategy designed to give smaller companies an advantage by using the perceived advantages of a larger competitor - namely size - against the competitor. It consists of three components: movement (using the smaller size to act quickly and neutralize a larger competitor's advantages), balance (to absorb and counter the competitor's moves) and leverage (using the competitor's strengths against it).Here, the entrant deliberately chooses to target specific niches with low prices. The incumbent is at a disadvantage because a larger customer base makes it difficult for him to cut prices. Hence, the incumbent is actually weighed down by its existing customer base.

The Game

There are two players in this game. One is the incumbent firm, who is currently the market leader in our product. The other is the entrant, which is a firm with present market share in the concerned product of zero, who is trying to enter the market. Let the price of the product currently being charged by the incumbent be P_H (high price).

The entrant sets a lower price of P_L (low price) i.e. $P_L<P_H$. Let X denote the market share of the incumbent firm. The entrant limits its capacity to serve only a small portion of the market (X_E) such that $X_E<X$. the entrant further signals the incumbent that it shall not drastically increase its capacity in the near future.

The incumbent now has two options. It can fight the entrant by setting its price marginally lower than that of the entrant's i.e. marginally lower than P_L. The incumbent will regain the entire market but will incur losses in the short run through price reduction equalling $(P_H-P_L)X$. The other option is to accept the incumbent and loose some profits by giving up market share (equal to X_E) to the entrant.

The incumbent will not attack the entrant if losses from accepting the entrant are less than the losses incurred through attacking the entrant. If the losses from accepting the entrant outweigh those from fighting them, then the incumbent shall retaliate i.e.

Attack if : $P_H X_E < (P_H-P_L)X$

Don't attack if : $P_H X_E < (P_H-P_L)X$

There are three factors here that influence the success of the entrant. The first is the size of the market share of the incumbent (X). If X is large, then the incumbent will not mind giving up a small portion to the entrant and will be less likely to deter entry. The second factor is the capacity of the entrant, which is reflected by the market share it is likely to usurp (X_E). The smaller is X_E, the less likely it is that the incumbent shall try to prevent entry. The last factor that influences the incumbent's decision is the price differential (P_H-P_L). The smaller is the value of P_H-P_L, i.e. the closer is the entrant's price to the incumbent's, the fewer the number of people who will buy the entrant's products, and hence the less likely will it be for the incumbent to attack.

The Rise of Amazon

This is the strategy adopted by online giant Amazon. Barnes and Nobel, founded in 1886, was the leading book retailer in the United States of America. In 1994, Amazon was founded by Jeff Bezos. It began as an online book retail store. Barnes and Nobel did not respond with their own online store, even though they had the potential to exclude Amazon. They feared that an online store would hurt sales through classical bookstores and would trigger an online price war, resulting in a Bertrand equilibrium. Gradually, Amazon began dragging customers away from classical bookstores. In the first two months of business, Amazon sold to all 50 states in the USA and to over 45 countries. Within two months, Amazon's sales were up to $20,000 per week. Since then, it has risen to become the world's largest online retailer today. Amazon now sells not only books, but also DVDs, VHSs, CDs, video and MP3 downloads/streaming, software, video games, electronics, apparel, furniture, food, toys, and jewellery. The company also produces consumer electronics—notably the Amazon Kindle e-book reader and the Kindle Fire tablet computer—and is a major provider of cloud computing services. Amazon is considered the fourth most successful startup company of all time by market capitalization, revenue, growth and cultural impact.

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ANSWERS TO CROSSWORD ON PAGE

ACROSS-

1. per capita income
3. comparative advantage
5. Harrod Domar model
6. Milton Friedman
9. infant industry
11. Solow
12. advalorem tax
13. J curve effect

DOWN-

1. Paul Samuelson
2. cyclical
4. deadweight loss
7. leveraging
8. disinvestment
10. repo rate

REVELATIONS

Economics is my hot samosa

Shivani Gairola
III Year

The thought of pursuing Economics Honours entered my head towards the end of class 12th. For the simple reason that in a life made bitter by gargantuan Physics equations and incomprehensible Chemistry formulae, Economics felt like Appy. It was cool to hang out with.

Halfway through college though, in one of the many epiphany moments a college student has, I figured out that Economics is not my 'thang'. I saw the excitement in the animated faces of my classmates as they discussed Sen and Dreze and the messed up Eurozone policies,and the most I was able to manage was an awkward ' Yeah seriously,that Merkel is a totes miser yaar'. I realised that I had no true passion for Economics and therefore, could not pursue it in life.

An Indian kid having such dangerous realisations can mean all sorts of trouble. It took some time and courage to admit it openly, but times have changed and it wasn't all that bad. Thankfully, I did find my true calling in another, unrelated field and declared in an Aamir Khan way 'Yeh mera passion hai", closed fists shaking and all. Am I to say that I wasted these three years? Well NO, I'm NOT Jon Snow and I do know something.

I am aware that when I don't want to have another pizza slice in my Pizza Mania combo, it's because of my marginal utility woes. I can tell you the exact place to open your ice cream shack on a beach.

I can discuss the subprime crisis at length without quoting the script of Inside Job. I can give the electric-rickshaw bhaiya a lesson in opportunity cost when he insists on waiting for the 5th passenger.

Sure, maybe this wasn't the purpose of my education but I feel rather good about these things. I know I will not formulate your tax rates or be the signature on your 100 rupee note, but I have learnt things that I can use even in Madison Avenue, swirling in my 'comfy yet fancy' chair.I sometimes forget the laws of motion or the formula for water, but you know that Economics did a number on you when Sherlock is sitting in front of a killer cabbie and all you can think is ' OHMYJEEZUS that's game theory mann'

You can take a girl out of economics but not the economics out of the girl. Keynes said that, look it up.

10 Interesting facts that will blow your mind

Surbhi Ghai
II Year

1. The International Labor Organization estimates a record 200 million people will be unemployed around the world in 2013. If you gave them their own country, it would be the fifth largest in the world.
2. 23. Apple's cash and investments are now equal to the GDP of Hungary and more than those of Vietnam and Iraq.
3. U.S. charitable giving was $298 billion in 2011, according to the Giving USA Foundation. That's more than the GDP of all but 33 countries in the world.
4. In the first quarter of 2012, the number of iPhones Apple sold per day surpassed the number of babies born per day worldwide (402,000 vs. 300,000), according to Mobile First.
5. According to economist Glen Weyl, "Of Harvard students graduating in early '90s and pursuing careers in finance, 1/3 were making over $1 million a year by 2005."
6. The International Energy Agency predicts that the U.S. will become the world's largest oil-producer by 2020, overtaking Saudi Arabia.
7. According to New York Times writer Binyamin Appelbaum: "Average months between US recessions since 1854: 42. Months since last recession: 42."
8. We are used to hearing how much faster the earnings of the top 1% grow compared with everyone else's, but we often forget that it used to be the other way around. From 1943 to 1980, the annual incomes of the bottom 90% of Americans doubled in real terms, while the average income of the top 1% grew just 23%, according to Robert Frank.
9. As of January 2013, there are 16 people left in the world who were born in the 1800s, according to the Gerontology Research Group. With dividends reinvested, U.S. stocks have increased 28,000-fold during their lifetimes.
10. If you divide their net worth's by their age, Carlos Slim and Bill Gates have each accumulated more than $100,000 in net worth for every hour they've been alive.

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IN CONVERSATION WITH LORD MEGHNAD DESAI

Meghnad Desai is an Indian-born British economist and Labour politician. He was awarded the Padma Bhushan in 2008. He worked as Associate Specialist in the Department of Agricultural Economics, University of California, Berkeley. He has also been a lecturer at London School of Economics and has taught econometrics, macroeconomics, Marxian economics and development economics over the years.

EB: Do you think the world has recovered from the 2009 financial crisis?

Five and half years later, we are still feeling the effects from it. UK's economy is just supposed to be recovering in 2014. American economy seems to be recovering. The European economies are stagnant since they have the peculiar problem of their currency. Hence, as far as the developed economies are concerned, they have taken the brunt of the financial shock. The crisis was very severe. Many financial corporations which encouraged risk taking. It gave people the false feeling that risk was reduced by equalisation. But the emerging economies were not that badly affected by it.

EB: What are your views on the Euro? Do you think that it will sustain in the long run, given the current crisis it has been through? Further, do you think that the decision of the UK to continue with the pound was a wise one?

To the last question, my answer is that yes, it was a wise decision. The Euro is a private currency and not a state generated currency. The government has no control over the currency. It does know how much gold came in or went out. The ECB cannot buy the debt of any Euro zone country, unlike the way the RBI can buy the government of India's debt. I am more convinced than ever that the Euro zone was set up in the wrong sequence. It does not have a fiscal policy because it doesn't have a union. So there is considerable problem.

I almost wish that the Euro zone would break up, but even that would be difficult. Greece came very close to breaking up. But if you exit, your own currency devalues. And Greece's debt would have been with the Euro zone. So they would be repaying the debt in highly valued currency. The best thing for the Euro would be to give commercial banks accommodation so that they do not go out of business. The way money supply of the Euro is managed is such that commercial banks can raise money from the central banks through government bonds. So money supply expands through private activity. Central banks cannot expand money supply. And their fiscal position is very tight. Their debt has to be financed by private debt holders. Thus, all that the European Union has been able to do is to create stabilization. It needs to adopt a severe austerity budget like the UK, which has now recovered.

EB: According to you, how significant has been the success of the IT industry, which is proclaimed to be a self-generated miracle, in India's economic development?

In IT industry, one has a first mover advantage, an innovative advantage, because otherwise you copy a patent. IT ceases to be significant unless you can continue to grow. The Infosys crisis shows that even the best firms can get it wrong. I don't think 15 years from now, IT would exist. Technology is moving too fast. We may not use all these laptops and just use our mobile phones in future. Basically, IT is just a sophisticated excuse for the elite for having failed at manufacturing. It is not going to provide employment to rural unskilled manual labour.

EB: Would it be correct to say that India's story today is a story of private success and public failures?

That is a false dichotomy. In India, public policy has always been an important driver. Public policy improved after 1991. Every independent country has its teenage years before it finally grows up. The teenage years of a nation last for about 40 years. China took 30 years, India wasted 40 complete years. But in 1991, we got serious. At that stage, public policy became less of an obstacle to the private sector. By and large, from 1991 onwards there has been a consensus among political parties that liberalisation is the way to go. So public policy is enabling.

I think that there is far too much inefficiency in the public sector, and much of it should be sold. It has been far too capital intensive, and the rate of return on capital is very low, as in the case of the *Navratnas* and other public sector enterprises. Public policy has got to be reforming in nature. Even now, the whole manufacturing issue is a problem of labour laws and inspection. In the past few years, scams have cost India a lot and slowed down its entire self engineering mechanism. What is governance? It is the quality of public decision making and the speed of implementation of such decisions. What is really wasting money is corruption and non implementation. All Asian economies have corruption, be it China, Korea or Japan. What is true is that in India, there is corruption and there is zero implementation. Private sector is also in a sense better at small and medium industries. Large enterprises are crony capitalists, very ill-behaved; they can't really survive in a really properly regulated regime. So, there's collusion between political and capitalist class, and that is how the whole mining crisis happened. Governments were colluding and were not stopping it, and people had to go to the judiciary

ultimately to stop it. The reason behind crony capitalism is bad politics. In India, politics is bad in terms of decision making.

EB: Do you think India's huge population is an asset for the country or a liability? Will India be able to reap the benefits of the demographic dividend?

If you invest in the population, then it is an asset. If you buy a house and don't use it, it doesn't become an asset. So the thing is that mere numbers do not matter. What we need is good quality of human capital, not just a large quantity of it. The Indian education system is very bad, and needs investment. There are also far too many restrictions on migration. People get distressed filling forms, getting them stamped and completing the entire lengthy process. Some of these restrictions have been encouraged to stay by local politicians. The new generation will get its dividend only if its quality is maintained and if it is allowed to take risks. I was looking at the paper today and the proportion of non working population is 60%. You are wasting more than half of your labour force. In UK, labour force participation is 77%. These are not restraints that you cannot relax. Women are not in the paid labour force. So India has much more potential.

EB: Beyond academia, you have played an active role in politics. As a politician and an economist, how do you view the contrast that exists between the populist nature of government policies and their economic viability?

These are two different areas. It's not necessary that politicians become good economists or vice versa. Politicians may make good economists in the form of say, Finance Minister. But politics is one of the most difficult areas of practice. Even economic theory is interpreted differently by different people. You can always find people with good degrees in economics, justifying their opinions in their own way! So economics is still a contentious subject.

Personally, I am much friendlier to free markets. Milton Friedman was laughed at for saying that exchange rates should be free and not fixed. But that whole thing actually changed peoples' lives. In India, economics has been, if anything, bad for country. There has been a lot of internal wastage. Somebody has to take up the role of public intervention about economic thinking. Politics is so powerful but so against sensible economics. Manmohan Singh came and liberalized a little bit, but he is very cautious. So I wait for sensible economics.

ED Board: Could you describe the differences that exist between left wing politics in India and that in UK?

Well, UK doesn't have left wing politics. Left track politics is all basically central politics. All across Europe, there is no distinctive social democratic left. In France, technically, the socialist party is in power, but it's not doing well. In Germany, the left is a part of the coalition. But socialist parties in Europe did not win elections after the financial crisis. Nobody went to the left to cure the problems of capitalism. And I think that from that point of view, the whole idea that there was a distinct socialist alternative is gone. Capitalism is gaining with time, and there is nothing one can do. I wrote a whole book about it called "Marx's revenge". In a sense, what happened was that when the Soviet Union collapsed, the whole Lenin's alternative disappeared. The left didn't realize that distribution needs to be supplemented by continuous production of

wealth. People didn't just see that all substantially non market based economies could perform well. When I was your age, we had no doubt that the Soviet Union would survive. For someone like me, the idea that socialism would not exist was unthinkable. But the USSR collapsed because of its own internal problems. And in India, nobody has noticed that. There's far too much consensual left in Indian politics. Socialism in India is basically populism. And the problem with populism is that it is economically irresponsible, because since it is distributing resources to the poor, the question is who really bears the burden. In UK, after each budget, there is an analysis of who really bears the burden. In India, nothing like that happens. On TV, I was watching a discussion where people were saying that the Aam Aadmi Party's free distribution of water is regressive. And even if it is not regressive, we want to know who actually pays for it? The UPA-II has been completely fiscally irresponsible in the last couple of years. What the left was actually supposed to do was to take up social reform. After 40 years of independence, caste became a dominant path for revolutionary politics. At that time, the really deprived people came close to political power, thanks to Kashi Ram and Manohar Ram Lohia, and that shows the utter failure of the left. The left thought in European terms, but they completely failed to deal with Indian reality.

ED Board: It is widely believed that poverty is a product of capitalism and removal of poverty requires some form of socialism. What is your take on this mistrust of capitalism?

First of all, socialism need not remove poverty. China deliberately abandoned socialism and took to capitalism. And though in India there is a great race to show that poverty is still high, but by any legitimate standards you use, the number of poor have fallen. Basically, poverty is removed if you make people productive. Unless average productivity of workers is high, India cannot be free of poverty. There are limits to income redistribution. Socialism's promise was that by redistribution, they would enhance productivity, but that didn't happen.

The ability of capitalism to continually transform itself by innovation is astonishing. My title "Marx's Revenge", was actually "Marx's Revenge on Lenin", but nobody understood that. Marx never ever said any such proposition that socialism would remove poverty faster than capitalism. He has given a very different reason why socialism can remove poverty, but that is possible only after the full maturity of capitalism. There is no socialist state that I know of where people's income standards are high and the dispersion of income is low. You can always have equality. Adam Smith has a word called servile equality. You can have equality of poverty, such as in North Korea and Cuba. But by and large, and people have chosen not to take that (socialism) path. The greatest development of the last 75 years is how people have abandoned socialism to take up capitalism. The entire Eastern Europe ran to capitalism, the first chance they had. Anytime a country could give up socialism, it gave it up. The fact that China gave it up is one of the most significant developments in the history of socialism.

EB: Do you think we have equality of poverty in India?

We don't have equality of any kind in India. I am a great believer in measurement, and I think that the NSSO is one of the greatest institutions in the world, and it has been measuring poverty consistently.

The statement that almost all of rural India is poor is also not true. The distance between rural and urban areas is gone. There are a lot of goods available in rural areas. Actually, one of the things that the UPA-II has done, partly through populism and partly through procurement prices rising and NREGA, is to enrich the rural areas. When the numbers come out, you'll see that the distance between rural and urban areas in terms of consumption is becoming narrower. To that extent, the old picture of rural and urban India is gone. Things are happening in rural areas that were not possible 10 years ago. Where I object to it is that productivity has not grown equally faster. To that extent, what is need is to drain labour from rural areas into urban areas, into manufacturing.

EB: Some people say that rural poor have now been displaced by urban poor. Is that correct?

The quality of urban poor and rural poor is very different. Even if rural poor have been replaced by urban poor, but the urban poor have access to much more public services than the rural poor. Urban poverty is mostly a matter of the quality of houses. Slums are basically impermanent structures. There are also impermanent structures in rural areas. But if you go to the urban slums in Mumbai, you'll be surprised at how many of them have running water and electricity. You may say that I choose not to invest in my housing but to spend more on my children's education by sending them to a better school. What is so great about a *pukka* structure? So, from that point of view, urban slums are basically people coming to urban areas and getting accommodated here. Lots of small and medium enterprises prosper in slums. And slums are the most efficient use of materials. You economize on land and space. Le Corbusier, a famous planner, decided that there was too much space between the floor and the roof. So he built an industrial worker's space which had bunk beds. That is exactly what slums do. Further, land is very expensive in India, and there is a big racket in infrastructure development. Hence, housing inequality is greater than any other kind of inequality. Maharashtra has even tried giving out permission for new buildings only if you re-house some number of slum dwellers, but people just sell them to someone else and move back to the slums. . The solution, thus, is not to remove all slums, but to provide facilities like better drainage and running water.

EB: Sir, you are of Indian origin. Just out curiosity, we would like to know what led to you being awarded as the title of 'Lord'.

I left India when I was 21 and went to the US. But later, I went to UK because the Vietnam war was on and I did not have a green card. When I was in UK, I was very supportive of the student rebellion and I joined the Labour Party. Later, I became Chairman of the Labour Party for six years. I began to take part in debates and so on. That's how I became a 'Lord'. It's not something I knew I was going to achieve, but it happened out of my contribution to politics.

ED Board: What would be your advice to prospective economists and young students like the readers of Aapoorti?

In my life, it is only hard work the refusal to accept any authority that has worked for me. Rebel all the time, and think positive. Nobody deserves 100% relief on any grounds. I never did well in India because I could not give the expected answer. Just remember that 95% of people are wrong 95% of the time, and you will be all right.

IN CONVERSATION WITH DR RAJAT KATHURIA

Dr Rajat Kathuria is Director and Chief Executive at Indian Council for Research on International Economic Relations (ICRIER), New Delhi. He has worked with the World Bank, Washington DC as a Consultant and carried out project assignments for a number of organizations, including ILO, UNCTAD, LirneAsia, Ernst and Young, Consultancy Development Centre (CDC) and Standing Committee for Public Enterprises (SCOPE). He has over 20 years experience in teaching and 10 years experience in economic policy, besides research interests on a range of issues relating to regulation and competition policy.

EB: Between 2000 and 2012, the emerging economies grew by almost 6% a year on an average. But since then growth has fallen by almost 3%. Do you think it is just a slight bump in the road or have the emerging markets had their run?

I think that the two major impediments to rapid growth in emerging markets have been the financial crisis of 2008, followed by the Euro crisis a couple of years later. There is a view amongst scholars that there is now what is referred to as the 'new normal', characterized by lower global growth.

Historically, we know that economic growth is associated by a marked shift away from agriculture to manufacturing sector and then to services, the latter becoming the dominant sector. All Western mature economies today reflect this pattern. Eventually, however, growth tapers off, because growth simply based on accumulation of inputs is subject to diminishing returns. The only way countries can sustainably grow is through productivity shocks and innovation. This fact does not apply to emerging markets yet as it does to mature markets because emerging markets can grow rapidly as China has, merely by accumulation of inputs.

Even so, China has been an outlier in the entire growth process because no country in history has ever grown at such high rates for such a long period. But even China has witnessed slowdown compared to the heady days of 10% growth. The global growth engine therefore points to a new normal since it is in the nature of things that growth will eventually come down because productivity shocks or productivity changes happen once in a generation. The last productivity shock was the dot com/IT boom. Now we are waiting for the next productivity shock for the world, which may come from robotics. But as far as emerging markets are concerned, they will continue to grow, if not as fast as the previous decade. One does not expect the likes of Europe or United States or even China to grow at 10%. Other emerging markets like India and Brazil that achieved high growth rates in the past will also not be able to sustain such rates in future.

Recall that India had grown at around 9% per annum for 5 years between 2004 and 2008, but our growth rate now is down to almost half of that. Other countries like Vietnam and Cambodia along with African nations are growing fast, but eventually there too there will be a decline. For India, the sharp deceleration is in part self-inflicted. Major but difficult policy reform can take us back to 8% growth rates. We plucked most of the low hanging fruit after 1991. To get our economy back on track, we need structural reform. There is not one thing in isolation that India needs to do but a host of measures are needed. These are fiscal consolidation, institutional and governance reform, improved enforcement and better and faster grievance redressal mechanisms, structural changes, etc. For example, in the course of execution of long term contracts between public and private parties in infrastructure, there are several disputes that will inevitably arise. Our malaise is that we suffer from a non-transparent and painstakingly sluggish dispute resolution process. In a market economy, you get credible commitment and conformity (to rules) when you have credible enforcement. India's policy is less of a problem, it is implementation that is worse.

We also need to create much better infrastructure, which unfortunately costs a lot of money. The 12th plan predicts a trillion dollars are required over five years for infrastructure projects. Fiscally strapped governments like ours do not have the luxury to spend such amounts when the fiscal condition is weak. Therefore, we need the private sector to step in, which they will for the profit motive. But private sector involvement means disputes. So one part of the story is better governance, better institutions, and better dispute resolution. The other part of the narrative is improved, transparent and efficient coordination among various government agencies. For example, every major country today has an integrated ministry of transportation. It means that policies regarding roads, railways, ports, civil aviation and urban transport are not made in silos but are coordinated to reflect the interdependent character of multimodal transport. Our policies, on the other hand, are made in silos with separate ministries for civil aviation, roads, and railways, who interact with each other once in a blue moon.

Besides infrastructure, we have a plethora of other problems like power, water, taxation, etc. Many argue that India is not one market but a group of 28 disparate markets. It is like Europe, but with exacting transaction rules among states. To break down these barriers would require a lot of deft political manoeuvring, which is politically demanding. Thus, the economics we learn in textbooks often seems impractical in the real world dominated by political interest.

EB: Economists believe that the tapering of quantitative easing by the Federal Reserve now will not be as disruptive as last year. What is your view?

Yes I believe that is correct. Back in May, the Fed's attempt to talk the markets to build in the inevitability of tapering triggered a dramatic, negative reaction to the rupee and other emerging market currencies. In response, RBI and other central bankers requested the US take care of the way the tapering of QE is announced. The announcement in May was unexpected but now markets have come to expect that tapering is inevitable and will be initiated.

Since then we have initiated measures to try and moderate the impact of tapering when it does occur. In India, the benefit of low interest rates elsewhere in the world has been dulled by stubborn inflation, high current account and fiscal deficits. Unless and until Indian corporate earnings rebound, the rupee and stock market will come under renewed downward pressure. QE for India has meant portfolio inflows into our capital markets; sharp withdrawals can potentially cause disruptions. Thus, to brace ourselves we need to strengthen our banking system and use domestic savings for domestic investments. We are also liberalizing FDI norms so that foreign investment comes for the long term and is not subject to short term reversals of capital. If we increase our FDI, we can do with lesser FII flows, which is why most economists press for FDI reforms and deregulations. Another way to reduce our current account deficit is to increase exports. If US economy recovers, then we will be able to do that. But eventually we need to desperately improve the competitiveness of the domestic economy. Curbing imports such as gold through higher tariffs are short term measures and will have to be reversed later. Increasing exports through structural reform has to be the sustainable way to improve our external position.

EB: In view of China having revoked its one child policy, its labour force will no longer fall into a 'precipitous decline' as suggested by the International Monetary Fund. What do you think would be the impact of this change in policy?

I think that China's one child policy was a bit extreme to begin with and could be successfully done in a regime that is not democratic. India also needs to restrain population growth, and we have adopted liberal and non intrusive methods like education, awareness about family planning measures, particularly in rural areas. Research shows that education has a strong causal link with lower birth rates.

Coming back to China, there are large interior parts that are relatively underdeveloped. By investing in these areas, China can yet achieve high growth rates. Revoking the policy now means that it will be almost a generation before China's new population enters the labour force. According to the ILO's definition, the productive age of an individual is between 15-64 years, but you don't actually start working before 21or so.

The other issue that the world is contending with now is "Green Growth". Climate change is a grave concern and it will be unrealistic to assume that China will replicate its high growth in the future. In Beijing, due to smog and high pollution levels, people have to wear masks when they go out. Hence, growth will come at a cost. Green activists claim that it is possible to attain high growth rates that are environment friendly. Others believe that growth will inevitably come at the cost of the environment. At current levels of technology, especially for emerging markets, if

you impose high standards on environment and emissions, the trade off is real. So one has to make choices and sacrifices. These sacrifices, in terms of growth, can, however, be limited by smart policies.

Countries like Japan and Korea are grappling with problems of an ageing population such as pension and healthcare. If the ratio between those working and not working is lopsided, it is a major problem. The government has to take care of this inter-generation transfer through tax policy. USA never had a one child policy but its birth rates declined.

The cost of having a child in Japan and Korea is prohibitively high and so people do not want to have kids. The old family network of grandparents bringing up kids is no longer possible. In countries like Russia, the Government provides incentives to have children (like free education) and yet they have negative birth rates. Emigration is an option in such cases. In Europe, most blue collar jobs are performed by emigrants, as locals aspire for high value-added jobs. Hence, revoking the one-child policy and ensuring high birth rates is not the same thing. Initially, people may have more children due to their new-found freedom, but birth rates may taper off in the long run.

EB: There are a large number of criticisms levied on the ASEAN-India free trade agreement. Do you think that India has more to lose than gain from this agreement in view of the limited market access of India in ASEAN countries that are predominantly export driven?

The agreement will undoubtedly give us more market access, at least on paper. The criticism is that we are not as competitive as they are. Those countries are export-driven and they will benefit more than us. The audit of our free trade agreements (FTAs) with Korea and Japan suggests that our bilateral deficit has actually increased after the agreement, which implies that they are exporting more to us than we are to them. Does this mean that it has not been a success? I think this is a narrow way of looking at it. All countries cannot run surpluses simultaneously. If one country has a current account surplus, there has to be a corresponding country with a current account deficit. In a lighter vein, all countries on earth can have current account surplus only if they trade with the moon! Politically, though, everyone is passionate about running a surplus, even though it is unrealistic.

At a broad level, the experience with Korea and Japan is similar to that with ASEAN: we run a trade deficit in all 3 FTAs. A comprehensive agreement like the one we have with Singapore that includes services and investment will allow us to leverage some of the benefits of such agreements.

One inference from the experience of India's economic partnerships is that we need to become much more competitive. We have a comparative advantage in the services sector, while ASEAN countries advantage is in manufacturing. Service market access is much more difficult than the market access for goods, because at one level, it includes trade in labour. Services trade is going to dominate in the future. And we should not shut ourselves out of the agreement just because we are running a trade deficit with ASEAN. The agreement will force our industries to face greater competition and thereby help apply pressure to improve. Take the example of our automobile industry, which has become quite competitive. We imported parts and components, and eventually, our domestic component industry also benefitted. If you can buy cheaper

imports and thereby become more competitive in the global market, it is good. We can calibrate the opening of our market not as an end in itself but as a means to an end.

For example, a policy that needs serious review is the 'inverted' duty structure in certain sectors. If one has zero or low duty on imports of finished goods (like TV sets), but components like picture tubes attract heavy duty, then we are disincentivising local manufacturing. This is an example of bad policy and we, as a research organization, are trying to provide evidence in favour of rationalizing such inverted structures. If we want the local manufacturing industry to grow, we have to allow them to import efficiently, so that, it helps domestic manufacturing.

EB: Do you think that the finance ministry will stick to its fiscal deficit target of 4.8% and the current account deficit will be contained at USD 70 billion, especially since the elections are around the corner?

All the more reason that they will try to achieve it. Mr. Chidambaram said recently that it shall be 50 billion not 70 billion. The larger question is whether these claims are going to translate into reality or whether they are populist. In the run up to an election, it's all the more imperative for the incumbent government to be able to deliver on their promises. I think that Mr. Chidambaram has a good track record and he will keep his word. He usually does not say things that he will not deliver.

The CAD target is easier to achieve given what has happened: gold imports have been restricted, exports are increasing, and hence the CAD is likely to be maintained within the target. It is more difficult to rein in the fiscal deficit, especially given that there has been a downgrading of GDP growth. But certain things like the telecom auction planned for February, where they are expecting revenue of rupees 40,000 crores, might enable them to. But I think that even if it's not 4.8%, it won't go terribly out of hand.

EB: What are your views about the efforts of the government to promote digital literacy in the country, such as the launch of the Akash tablet and the National Digital Literacy Mission? Do you find them commensurate with the existing challenges?

With 900 million mobile phones, a plethora of applications, increasing use of IT in public service delivery, and Aadhaar cards being given and matched with bank accounts, I think digital literacy is now extremely essential. I feel we are well aware of the need, including for the less advantaged rural areas. Several experiments in which NGOs provided computers in slums, where no child had seen a computer before, show astounding results. So, digital literacy will inevitably cover everyone in the next generation. The challenge is the present. Sam Pitroda's mission of linking 256,000 gram panchayats with a national optical fiber network of minimum 2mbps speed connectivity is a start. You then have Aadhaar cards, then banking access, and so you can build one layer upon another. Infrastructure is however a necessary condition; digital literacy, applications, consumer awareness are all parts of the eco system that need to occur simultaneously for maximizing impact.

EB: What are your views about the upcoming "app" economy in the context of India?

I'm very optimistic about the 'app' economy in India. We're doing a study in fact, in ICRIER, on the app economy. In a country of 1.25 billion people, I think, it is natural that it will have a significant impact. If you ask me this question two months later, I will give you evidence based quantitative response. There are apps for mobile devices, iPads, smart phones etc. Development of apps gives rise to an entrepreneurial activity and of course the spirit that is crucial in a country like ours where 50 percent of the population is less than 25 years of age. Apps create employment opportunities, enable better information flows, reduce information asymmetries and slash transaction costs. But I don't have a number right now to back this claim.

EB: What are your views on the bitcoin, which is being propagated as the new global digital currency? Do you think it is feasible or is it just a short-lived craze?

I think it's a short lived craze. Currencies work with confidence and trust. You destroy trust and confidence and the currency will be ruined. Despite decline in the US, the dollar remained the premier currency because people have confidence in the dollar. What is it in the dollar? What is it in gold? It's trust. Otherwise it's a worthless piece of paper or metal. The point is that the ultimate test of a currency lies in the confidence or trust that people have. And why do they have it? Ultimately, it's because the government of the day backs it. The Indian rupee today is more credible than it was in the 60s and 70s, so people are putting their money behind the rupee (metaphorically). Bitcoins don't inspire the same confidence.

Another reason a currency retains value is because you restrict supply. You don't just print indiscriminately. If you do, then it will become worthless. That aspect has been ensured since the supply of bitcoins has been capped. But its greatest weakness is that it's not backed by any government i.e. the legal status of bitcoin is unclear, as is evident from the fact that recently big governments have started to warn people against its use or any other digital currency. Money is an integral part of how a society operates and a stable monetary system is one of the pillars of functioning of a stable society. In a limited sense, bitcoins have worked but you'll be foolish to put your money in it. It's never going to be a substitute for currency.

The financial crisis has also made banks much more careful about money laundering. Anti-money laundering rules may be one reason behind the success of the bitcoin. And it could still be successful for a short period. But for the long term, I wouldn't bet on it.

EB: What would be your advice to prospective economists and young students like the readers of Aapoorti?

You're studying a popular, great and extremely interesting subject. My advice would be to supplement textbook reading and classroom learning with a lot of other reading, besides the recommended ones. Read current affairs, and try and get to know the world around you. These are very interesting times for our subject. But textbook economics and economics of the real world are quite different. While there is no substitute for theory, look for ways to apply what you're learning to the real world. Talk to as many people as you can outside the classroom. And if you combine economics with other related fields like political science and law, the enjoyment and value will only multiply.

IN CONVERSATION WITH DR E. SOMANATHAN

Professor E. Somanathan received his Ph.D. in economics from Harvard in 1995 and taught at Emory University and the University of Michigan at Ann Arbor before joining the Indian Statistical Institute, Delhi where he is a Professor in the Planning Unit. His current research is in environmental and development economics and ongoing research projects include the impact of global warming and aerosols on Indian agriculture and the distribution of income, and game-theoretic modelling of climate policies.

EB: Do you think there is a trade-off between environment and development?

There is usually a trade-off if you want to do something about an environmental issue, but it is also often worth making. For example, if you want to control pollution from cars in the Delhi area, it is going to cost something, because then you have to make some investment for pollution control equipments, people have to buy fuel efficient cars etc. On the other hand, the reason why it may make sense to carry out these actions is because these externalities can have effects which reduce your ability to produce and consume. For example, if pollution affects your health, then it decreases your productivity and consequently your income falls. We might also want to undergo the costs if the savings that we get are larger than the costs. Ultimately, the question is of a cost benefit analysis.

EB: Market economics fails to put a value to the ecological and cultural loss that is entailed in the name of development and industrial progress, such as in the case of dams in the country. How do you view this lack of any valuation system?

There is a misconception when it comes to monetary valuation and green accounting of environmental objects, say a river. You don't value the river. What you value is the particular changes in the attributes of the river. So for example, the current oxygen demand might be 100 units rather than the current 50 units. An increase in 1 unit per ml can be valued as a Re 1 or Rs 2 benefit. So what you are valuing is changes in some attributes, say some pollutant level for example, so you might value the quantity of change in the flow. But you don't usually value the

river in full because it's not a meaningful thing to say. What do you mean by the value of the Yamuna? Say if you value it at Rs 4000 crores, what do you mean by that? That we would have been Rs 4000 crores poorer if the Yamuna didn't exist? It's not a meaningful thing to say because the choice isn't about whether to have the Yamuna or not. You can say there is 1 unit more of x, y or z in the Yamuna or some amount of pollutant in the air of Delhi. What you are valuing is 1 more unit of that. But it is not the same thing as valuing the whole thing.

The reason why it's important to know that you are valuing changes is because demand curves slope downwards. So right now I may be willing to pay Rs 10 per bottle of water, but if I have no water to drink for two days, then I might be willing to pay probably everything that I have for that bottle of water because the value implied is higher. The point is that since I already have plenty of water to drink, the additional bottle is not worth much. So if you go from there and value all the water on earth, you can take that price, which is Rs 10 per one litre and multiply it with all the water on earth, then the number that you get is what economists usually call a serious underestimation of infinity. The reason behind it is that when are setting that price, what you're getting is the marginal value given the fact that you already have a lot of water. You are ignoring the fact that as the quantities go towards zero, the prices will move towards infinity. So your valuation will not show that at zero, your willingness to pay will be infinity. That's the fallacy that has unfortunately been committed by a lot of people. So that is what I mean when I say you can't value the whole Yamuna, because that's not a meaningful thing to say. Hence, you value in changes in particular things. You can value the pollution level in the Yamuna, but that doesn't mean that you are valuing the river.

The question now is: because of monetary valuation and green accounting, are we somehow devaluing things because we attach a monetary value to them? But what we are valuing is the current position, and all that we care about is then expressed in one number. Hence, the issue basically reduces to whether we are capturing all the things that people truly care about.

EB: Talking about pollution controls, what do you think is more effective - market based economic instruments such as pollution taxes and marketable permits, or command and control policy options such as mandate caps on pollution and pollution reduction targets which are applied across polluters by government decree?

These economic valuations are subjective and should be used with a great deal of caution because there is a lot of unpredictability. Economists have developed methods to do the valuation, but they are highly imperfect since they leave out certain aspects and involve a lot of uncertainty. Therefore, you should treat those estimates modestly. The important thing that the valuation can point out is that at least this much damage has been caused and one aspect of the harm caused by pollution is determined. Then it can be compared with the costs of cleaning up that pollution and it is useful regardless of all these other values which only add to the ultimate.

I don't particularly like market based economic instruments. However, there are two basic market based economic instruments- price based economic instruments and quantity based economic instruments. Price based economic instruments would imply taxes and subsidies, because they change the prices of the final goods. Quantity based economic instruments are tradable permits of some kind, i.e. you set an aggregate quota and then you allow people to trade based on the total quota. Both these instruments can, however, be used only in limited situations. One reason is that is we often cannot monitor the situation. For example, we want to

have tradable permits for automobile emissions, but it's difficult to monitor them. Hence, we can have a tax on diesel or petrol, which is a partial incentive based instrument. And it has partial effects in the sense that if we have higher prices of diesel, people will want more fuel efficient cars, so companies will produce more fuel efficient cars and if they do that, fuel emissions will go down. Generally, people will drive less because driving is more costly, and so there will be less emission. The advantage of that kind of instrument is it has an action on various kinds of markets. People drive less and the cars that they do drive are less polluting. Adjustments are made by various agents in the economy: the drivers, the owners and the producers of cars. So there are various changes occurring to accommodate the change. Now imagine that we are instead going to regulate the quality of fuel. Say there will be no more than 10% of sulphur in the fuel. If more sulphur content fuels were used previously, then there has to be a switch to lesser sulphur ones, leading to lesser sulphur dioxide emissions. So air pollution is reduced. But this effect is happening by just one agent, which is the refinery on whom the regulation is imposed. They have to make some investments to reduce the sulphur content in fuel. All the other agents don't make any adjustments. But that doesn't mean it is less effective. Therefore, the big advantage of market based economic instruments is that they tend to give incentives to everyone in the economy to make the adjustment. But the disadvantage of this is the narrowing of the effect, i.e. you can have a tax on diesel, but it will not change the quality of the diesel, only the quantity. It doesn't change the fact that when you drive your car, there will still be pollution.

EB: But sometimes a cap on pollution levels on industries is effective.

Yes, limiting the amount of polluting levels is effective, but it's not as effective as setting up a maximum level of pollution and allowing the industries to trade. In addition to this, there will be additional costs involved in monitoring each factory's pollution level. We will need a trading system and an institutional set up to check the permits and to know how many each one is holding, and then to make sure he doesn't violate that amount.

EB: Which one is better?

Well, trading permits do not work, except for pollutants that can be mixed. For example, if I set an aggregate cap for the brick kilns in western UP in terms of how much smoke they can produce, then if it is cheaper to import bricks from eastern UP instead of producing in western UP, there will be huge amounts of pollution in eastern UP. Hence, the problem here is that the pollutant is not uniformly mixed. So trading doesn't reduce pollution and you cannot let western and eastern UP to trade. So if a pollutant has local effects, then trading has a limited scope. Carbon dioxide is the only universally mixable pollutant which leads to global warming and therefore, there is trading for carbon permits.

EB: How significant do you think has been the impact of social movements that attempt to conserve the environment?

I think that the impact has been very significant. The *Chipko* movement, for example, was hugely successful and stopped the felling of trees in the Himalayas. People today are much more aware than they were in the past. Nevertheless, there is still a lot more environmental knowledge and awareness that is needed.

EB: What is your view on the higher education system in India? What are its problems and how those can be solved?

Well, the fundamental problem in Indian higher education is that we don't have enough colleges to cater to the existing demand. And even lesser colleges of good quality. There is a demand-supply mismatch. We also have a problem of access. People from privileged backgrounds generally have much better access to quality education than people from poorer backgrounds. The main reason why this is so because the government has a terribly broken system of funding education. For example, the college fee of Delhi University students is Rs. 8,000 per year. But what is the actual cost per student? It is probably, I would guess, 20 times higher! The average all-India cost per student seven to eight years ago was Rs. 85,000 and in a college like Miranda House, which is much better than the average quality, it would be even higher than that. By now, it would be Rs.1,00,000 i.e. you're paying only around five per cent of the cost! The effect of this is a drain on the government resources. To make sure that its budget is not drained even further, the government regulates the expenses of the colleges, mainly the salary of the teachers.

How would you fix the system? You need to realize that a lot of those who go to the university can easily afford to pay the full cost. How would you know that? Because parents of those children who are deciding to send their wards to a college in India are also deciding at the same time whether to send them to America. And how much is the cost in a college in America? Say, around $60,000 a year, which is roughly Rs. 40 lakhs a year. Hence, it is better if you subsidize only those who really need the subsidy, and not everyone. These savings can help the government build many more colleges and universities.

The second issue is the problem of centralization in universities, i.e. bureaucrats telling the universities that you can't spend more on this, or you can't promote this teacher because if you promote him/her, then his/her salary will go up, which will have to be paid by the government. The government needs to change the process of funding. Instead of giving out money to universities, what if it gives money directly to students? Say, it pays the tuition fee for a student below some threshold income level. Above that level, government may either just partially subsidise or not subsidise at all. Here, although a lot of students don't get the subsidy, but you have a lot of money that can be used to fund say, education of students who never went to school. Secondly, you take away all these regulations from the universities. The university can then set up an incentive system for teachers, which will improve the teaching standards too.

EB: You have been to Harvard as a student. How would you contrast it with the Indian education system?

Well, it's not a fair comparison because Harvard has a lot more money. Yet, in India, we can greatly improve things with the money we already have. It can happen if we decentralize the system, and if we give the money out to only those who actually need it. Another problem is that the government regulates the fee structure by keeping fees low. But with low fees, you get poor quality colleges because then you're not attracting good people into the teaching profession. In terms of the quality, overall the state of higher education is really pathetic in India. There are very few colleges of comparable quality.

EB: How relevant do you think is the existing reservation policy in elite educational institutions in the context of job creation, and has it been successful in equalizing career outcomes for the backward classes?

No, it hasn't. This is because the problem starts right after you go to nursery school. People from Scheduled Castes are more likely to be poor. They have greater probability of mothers being anaemic, children being underweight, infant mortality rates being high etc. Inequality starts from there itself. These children usually go to government schools because their parents can't afford private schools, and, as you know, government's schools are very badly run. Dropout rates at every stage are very high. So by the time you get to the college level, the proportion of SC people coming out of school is very small. By the time they graduate, only 5 or 6 of them are left. Thus, if you want to solve the problem, you have to tackle it from the start.

EB: Do you think that the view of investors with regard to India has suffered a setback, given the policy paralysis that we have witnessed, and what, if anything, can we do to rectify it? Since we have elections every five years, there is a possibility of the policy paralysis continuing for a long period of time. Further, politicians undo the policies that their predecessors undertook, and this may send out conflicting signals.

I don't think that policy paralysis is the whole story. It's certainly present, but you shouldn't overestimate it. 99% of the things that get done stay that way. It's only 1% of the things that get changed. And out of these, about 50% of the time they should be reversed. It's also true that the things that work well are going to be the things that are not reversed. A lot of laws are passed that are uncontroversial; they don't even make the news, but its policy nonetheless. "The law didn't get reversed", this is not a headline. The headline is when something is reversed. So yes, policy paralysis is an issue, but the economy is still functioning, which means that work is being done. Further, it's not at all clear whether elections improve or worsen the quality of governance.

EB: What would be your advice to prospective economists and young students like the readers of *Aapoorti*?

I guess the most important thing is to try and verify the facts for yourself. So if somebody says something or you read that this went up and this went down, just Google around a little bit and find the data. Did it really go up? By how much did it go up? Or did it really go down? By how much did it go down? Try to be aware of the main facts. Look at the data. It's not hard to get data nowadays. It's easily available on the internet. So check facts. Do not let opinion pass by you. Don't quote unquote because somebody said it. So check things. Check the data and get a realistic picture of the event, and you'll have a much better understanding of economics and the way the world works. You will also soon be easily able to tell whether this is a plausible statement and likely to be correct or an implausible statement, likely to be incorrect.

VISHLESHAN

Core Committee, Vishleshan

It is imperative for economics students to know about all the macroeconomic issues that occur around the world, that directly or indirectly affect our lives. As our syllabus does not cover such contemporary issues due to time crunch, it was suggested within the student fraternity that this idea of holding regular lecture sessions by eminent personalities, will cover such issues and diffuse the knowledge not only among economic students but also those of others streams.

This discussion forum, where discourses are given by academically brilliant person is named "*Vishleshan*". Its vision is to infuse to knowledge with analytical insights in students so that in future these students may have the power of knowledge and effective tools to bring amends and avoid any economic catastrophe.

First Session: Whatever happened to the rupee

In the inaugural session of Vishleshan on Wednesday, 25th September, 2013, we had amongst us Mr. Rohit Azad, Assistant Professor, Centre for Economic Studies and Planning, JNU to discuss with us one of the then pertinent topics "Whatever Happened to the Rupee?" Given below is the synopsis of the same:

Is it falling primarily because of international pressure?

It is believed that the decline in the value of the rupee was due to Federal Reserve's Ben Bernanke's announcement of withdrawing the policy of monetary easing which caused the capital to flow out of India, which in turn caused the value of rupee to fall(when there are capital inflows in a country, it currency appreciates and vice versa). But if this would have been the case then the rupee wouldn't have fallen against the yen, euro and pound. Moreover the rupee had started falling much before the announcement. Thus this proves that Bernanke's announcement of monetary tightening was not the real reason.

Then why is it falling? An Alternative Explanation

There is growing trade deficit i.e. our imports are very high whereas our exports are falling and are way less than the imports, this is leading to high current account deficit(CAD). This is because we have a high import demand of oil and gold. Oil is a necessity as it is a major source of energy production and hence used by almost every industry and people cutting across all classes, thus we cannot do much to cut down on the oil imports but we can certainly cut down on gold imports as it is more of a luxury good which the richer section of the society buy, to bring down the current account deficit by imposing high import duty. Some may argue that this will lead to smuggling but the black money (unaccounted money which apparently does not exist in the system) that will be used for smuggling will not affect the value of the rupee vis-a-vis other currencies.

Exchange rate and Sensex: Why are they moving together?

The stock exchange prices are highly influenced by the inflow and outflow of capital. When there is an outflow of FII and FDI then the stock prices fall dramatically. Thus there is a need to have regulations to curb such easy mobility of foreign capital to reduce the volatility of Sensex prices and hence the vulnerability of the rupee.

Second Session: India at the crossroads and the way ahead

We had amongst us Dr Subramanium Swamy in the second session of Vishleshan. Dr Swamy is an important leader of the BJP and has taken a stand on several occasions against the wrongs that rampantly plague the Indian society. He played a very important role in exposing the 2G scam. Here are the highlights of his speech. He started his speech by telling that India is at a T junction i.e. it does not have a definite way ahead from here, as we are struggling with a low GDP relative to what was targeted or aimed, high inflation, and a lot of macroeconomic instability.

He emphasised the role of politics. He said that even though it takes a credible effort to frame a blueprint of an economic policy whose objective is to redress the economic conundrums but the real work lies in getting the policy implemented. This role lies within the ambit of politicians in power, but then he emphasised the fact that there is an important rule that elected representatives should follow while implementing such policies–that the policy should not just

have long term benefits but also have some immediate benefits, because in a democracy it is important that people see results and it is only then that they place their faith in politicians.

After this he started discussing the ways in which Indian economy can be restored to its phenomenal rate of growth and can well be back on its path to be the next global power.

According to him, agriculture has the maximum potential and it is by concentrating on this sector we can transform our economy.

Only 25% of the land in agriculture is used for growing more than one crop a year, and in the rest 75%, only one crop a year is grown, thus in this way, full utilization of resources (land) does not take place. Another product in which we can be a major exporter is milk.

Next, he emphasized that we should spend more on developing research and development institutions, so that the youth aspires to be entrepreneurs with innovative ideas.

He said that in western countries the universities are funded by the alumina, and similar pattern should follow in India so that the government doesn't intervene in the system and the curriculum can be devised according to the need of the hour.

Then he gave the statistics regarding money laundering. In his opinion, the big fishes who stash their money in tax havens should be targeted and income tax should be abolished altogether as the poor do not come under its ambit, rich hire specialists to evade taxes and the burden of income tax falls only on the professional middle class. This will stop money fleeing to other countries and will get invested in our own country which will spur growth.

Corruption is an important issue that needs to be addressed. He suggested that to reduce corruption, procedures should be simplified and digitised to maximum possible extent so that the discretionary power in the hands of officials is reduced.

He also gave a political reason for the depreciation of rupee, he said that people very close to people in seats of high position and power do not let measures be taken that can appreciate the value of rupee against dollar for their own vested interest.

In fact, he explained the mechanism through which people use black money to make more money: People take loads of cash (unaccounted black money) to tax havens like Switzerland & Mauritius and from there they get "participatory notes". These notes carry the amount of money in dollars without their names written on it and they can be traded legally in India without any enquiry, the law designed is such. When the value of rupee goes down against the dollar, they go to RBI and ask them to give cash in return of that participatory note.

Besides entering politics, what we can do is, form a group of 5-6 people, take the list of 1000 people from a polling booth station, see which all people in the list still stay in that constituency and have not migrated and then convince the remaining ones to cast vote for the candidate or party you thing is best or is the least worst. This way we can make our contribution towards changing the society because the time allowed for campaigning is only 15 days and the candidate cannot cover every house individually in this short span.

Third Session: Corruption and Governance

We had the third session of Vishleshan on 29th Jan, 2014. The speaker was Dr. Arvind Virmani, an eminent personality. He has served as the principal advisor to the government, member of planning commission, chief economic advisor to the Ministry of Finance and has also represented India at the IMF (International Monetary Fund). He has had the reputation of being an honest bureaucrat.

According to the speaker, the problem of corruption primarily started with the license permit quota raj system which gave the power in the hands of the government officials to give approval or green signal to entrepreneurs to start their venture or to be able to execute a project. He insisted that there should be systemic reforms which should translate the role of the government from the one who carries out business to one who only regulates it and not "control" it.

Government's over extended leviathan

The government has tried to take under its ambit a large range of subjects like policy, programs, art culture and enterprises. According to the speaker the role of government is just to make laws and ensure their strict and consistent implementation so that all the activities in the economic and political sphere of the economy run smoothly.

Other major flaw that he encountered with the governance was that there are new laws being implemented every now and then to resolve existing issues but the manpower needed to implement these laws is not increased, which means we have more laws to ensure safety but the same number of police officials as before, we have more health policy but doctors haven't increased, and each city has almost 250-300 welfare programmes under just one district magistrate(DM)—all this clearly proves why new laws can't be implemented efficiently and thus there is no visible improvement.

Policy and systemic reforms

According to the speaker all the shares of the public sector units should be sold to the private companies as they are more efficient. Natural resources like coal and minerals should be auctioned in the market as the prices of these resources can be known only by the" willingness to pay".

There should be reforms in the police such that the onus of investigation lies on another department as the police officials have no incentive to do so. There should be reforms in the judicial wing as well so that a person is not allowed to appeal so many times to the higher court when judgement is pronounced against him. The process of appointments should be more transparent. A witness who is caught giving false statement should be persecuted.

In a nutshell, he advocated an urgent need to innovate ideas that will eliminate corruption from every level of governance.

They all enlightened us with their erudition and cognizance. During their visit, they inspired us in more ways than one.

ALUMNI LECTURE SERIES

Understanding 'India' Sustainably: The economics and politics of resources

Lecture I: Coping with energy resource scarcity...sustainably?

"The question whether the glass is half empty or half full has a third answer, there is too much glass for the job to be done!"

This aptly reflects the current energy situation in India- that it may not always be about lack of accessibility of energy sources but about the limited supply or naturally constrained availability of the energy sources in the country. Thus, any solution to cope with the growing concern is to reduce the size of the glass itself, that is, to reduce consumption to make it more sustainable.

To reflect upon the issue of sustainability of resources, the Department of Economics held the first lecture as part of the series entitled "Understanding 'India' Sustainably: the Economics and Politics of Resources" on October 1, 2013. The lecture was delivered by Dr. Nandita Mongia, a senior academician and adviser to the National Clean Energy Fund, India. This lecture is also a part of the initiative by the department to increase interaction with the alumni of the college.

The lecture began by highlighting the foundational distinctions among various energy sources. A common terminology used in the energy sector is primary and secondary energy. Primary energy is the raw coal, oil and petroleum and secondary energy uses them to make energy. Commercial energy is the energy that we buy and sell while non commercial energy comprises of energy sources like bio mass fuel. Another common terminology used is renewable energy sources (those that can be regenerated easily within a short period of time) and non renewable energy sources (those that cannot be regenerated within a small time period).

Dr Mongia then explained the concept of sustainable development with reference to the 1987 Brundtland Report, which defined sustainable development as the development that meets the needs of the present generation without compromising the ability of future generations to meet their needs. Three aspects need to be met for a country's development to follow a sustainable path: social objectives, environmental objectives and economic objectives. We need to reach a point where all three are completely integrated.

Dr Mongia then took up the issue of oil. There is a huge mismatch between supply of and demand or oil. Hence, its price rises and subsidies need to be provided. This translates into a budget deficit which in turn translates into a foreign exchange problem.

The next issue to be discussed was the composition of rest of the energy in India. Thermal power, which is primarily coal, is the major source of power. But it is called the "dirty" fuel in terms of pollution. However, there is a solution to it – renewable energy. The use of renewable energy sources has risen sharply over the years, which is good news. Renewable energy is costly upfront, but if you look at the environment cost it compensates for, or if you internalize the

external damages, then the cost of damages is much more than the cost of the energy. In India, renewable wind energy is huge whereas the proportion of hydro energy is small comprising merely 15%. Also, bio mass solar energy comprises 14% and 6% of the energy source. These meagre proportions are not sufficient to serve the needs of a large population like ours.

Decentralized energy generation, like a district heating system, is not common in India, but it is otherwise an important tool for sustainable development. We have more than 800 million people living under $2 a day while75% of our population needs just basic energy. A possible intervention on the supply side is with regards to supply efficiency. Usually, when thermal plants generate electricity and transport energy, some energy is lost in the process. Our transmission and distribution loss is around 30%. Most of the coal power plants are very inefficient. Coal producing technology is old, and so we are not producing the maximum that we can produce without setting up new power plants. The need of the hour is to bring in energy efficiency. Ever since India has enacted the Energy Conservation Act, it is compulsory to have labels on electrical equipments with the number of stars denoting how much electricity they save. These norms need to be followed by everyone.

And, of course, everyone should strive towards the goal of reducing the size of the glass itself!

Lecture II: Water, culture and power: Economics for the 21st century

In the second lecture under this series, we were fortunate to have amongst us Dr. Amita Baviskar who is a highly renowned academician and an associate professor at the Institute of Economic Growth, University of Delhi. She delivered a very interesting and enlightening lecture on the intertwining issues of environmental economics, politics of water resources, conventional economic cost benefit analysis and valuation systems.

She began by highlighting the various conflicts that exist in the current valuation system i.e. the way different sets of people value resources. We have local traditional communities that respect and value forests and the environment and use them judiciously for meeting their basic subsistence needs of fodder, food and timber. Conversely, we have the forest officials, with their single minded focus on tapping the economic benefits by clearing larges acres of land and planting it with cheer pine, which provides commercially valuable products like timber wood and gum. Thus, while no major monetary value is attributed to subsistence activities (fuel and fodder wood collection of traditional communities), the planting of commercially profitable species of trees like the cheer pine shows up as a great income source and caters to the needs of the consumerist urban class, while destroying the very source of livelihood of local communities. Moreover, it is difficult to ascertain in monetary terms the ecological and cultural loss that is entailed in the name of development and industrialization since market economies fail to put a value to the traditional belief systems of village communities, the aesthetic beauty of the environment and local indigenous culture.

It has also become increasingly important to analyze the issue of power relations, which is responsible for inequity and unprecedented destruction of forests. The question of power relations can be addressed in economics only in a limited manner that can be seen in the views of Karl Marx, who talks about industrialization as an empowering force for the worker community, which will enable them to fight for their rights. According to Dr Baviskar, since economics is the dominant discipline used in policymaking, we need to look at the broader

issues that economics does not incorporate such as valuation methods and managing development in a sustainable way.

By citing the example of Nobel Laureate Elinor Ostrom who studied common property resources and illustrated the important role that the local communities play in efficient management of local resources, she stressed on the need for integrating the local communities and involving people at the grass root level for policy making.

She also talked about the growing fetishism and the misplaced notion of scarcity of resources and hence, emphasized the need for judicious and frugal utilization of the resources rather than the myopic focus on creation of new supply sources, which has led to major ecological disturbances and environment degradation. She elaborated as to how the problem was not of resource scarcity, but rather of inequitable distribution of the resources and focused on the question of big dams in India.

She negated the popularized belief of big dams being crucial to sustain India's development needs and explained that it was the reckless use of water resources through unsustainable practices like cultivation of water intensive crops, water logging etc which has led to water problems and forced us to analyze as to how accurate our assumption of scarcity is, what should be our approach to the question of scarcity, who should bear the costs and who should get the benefits.

She also stressed on the need for a complete reassessment of the belief that "there is no alternative and someone needs to be sacrificed at the altar of development", as it is only the poor and the tribal who are time and again required to do so. She presented her experience of the Anjanwara village of Madhya Pradesh where Bhilala *adivasis* struggled against Sardar Sarovar dam project to fight for their survival and dignity, and in the process lost all. Their village has now been submerged leading to a complete loss of indigenous culture and their traditional way of living. Without any rehabilitation and resettlement programs, they are now forced to live in destitution.

Today, dams are largely seen as a visible symbol of development and a solution to the increasing energy needs of India and have captured the imagination of politicians and bureaucrats alike. However, what is largely ignored is the fact that dams mostly cater to the requirements of the urban elite, who continue to consume and demand more, and the larger costs are always borne by the most vulnerable and marginalized sections that lose their indigenous culture and ancestral land in the process. Along with the cultural and social costs, there is huge environmental damage and loss of biodiversity. Moreover, dams have also failed to deliver on the promise of greater irrigation efficiency. This can be seen in a World Bank report that states that average irrigation efficiency of big dam projects is only 40%. In fact, the most fertile plains of Punjab, Haryana and Tamil Nadu have been harmed due to excessive water logging resulting from these projects.

It was an extremely instructive session and Dr Baviskar left us pondering over extremely relevant questions such as how to try and respect the rights of the most marginalized and vulnerable people by applying appropriate tools and instruments one has as an economist, how we can live in harmony with nature within the framework of economics, and how we can address the issue of respect for mother Earth, who belongs not only to humans, but to the entire range of species that inhabit the earth.

CARICATURES

By Swaril Dania

II Year

WORLD AFFAIRS

Hydrocarbon Wealth: The fool's gold

Surbhi Ghai
II Year

The dynamics and analysis of oil curse

"Ten years from now, twenty years from now, you will see, oil will bring us ruin", said the OPEC cofounder Juan Pablo Perez Alfonzo during the 1970s oil boom, when oil was first discovered in Venezuela and many other African and middle eastern nations. He called oil "the devil's excrement" and his words were much censured then. But he was proved right: the euphoria of the oil boom was transient. It left behind in its wake a hangover whose effects still reverberate, particularly within the colossal expanse of the Middle Eastern and African nations that remain victims of the 'oil curse'. These nations are bestowed with an abundance of hydrocarbon wealth (i.e. presence of huge reserves of oil and petroleum), which, in accordance with economic rationale, should have essentially lead to greater amount of prosperity, affluence and development. However, this is not the scene today, for many of these countries (i.e. Nigeria, Angola, Equatorial Guinea and Chad) remain plagued with civil war, social unrest, military coups, poverty, gross violations of human rights and instability, despite their hydrocarbon wealth. This is what is called the 'paradox of plenty', or more particularly 'the oil curse', where possessing sufficient wealth in the form of hydrocarbons not only decreases the prospects of economic development but also increases the prospects of instability.

This paradox was first explained by Richard Auty who postulated the resource curse thesis in 1993, whereby he proposed that countries rich in natural resources had lower economic growth compared to their resource deprived counterparts. Examples include the Asian states of South Korea and Japan, which are the world's most export oriented economies despite a lack of natural resources. A deeper analysis of the realm of economic and social institutions of oil rich nations show that there exists a set of well coordinated forces that work in synchrony with each other and gives rise to the paradox that turns this apparent blessing into a curse.

Dutch disease

Firstly, presence of excessive reserves of hydrocarbons and their exploitation leads to what is called the "Dutch disease" i.e. the slowing down of economic growth through a decline in local productive sectors. This

decline is a result of huge appreciation of the exchange rate brought about by surplus oil export foreign revenues, in the presence of floating exchange rate mechanism. The "Dutch disease" is named after the infamous Dutch experience in the 1950s when the discovery of oil reserves led to an unprecedented increase in foreign revenue along with bloated value of local currency. This had an adverse impact on the local manufacturing and service sector as manufactured goods and services became expensive and were unable to compete in the international market. Consequently, imports become cheaper and this further aggravated the plight of the local trade sector. Manufacturing units became sick and ran into losses that lead to a general increase in unemployment and a decrease in productivity of the economy as a whole.

Angola, which is Africa's largest oil producer and has one of the richest hydrocarbon endowments in the region with oil revenue amounting to $16.2 billion in 2009 has been experiencing Dutch disease since the 1970s. Due to abundant revenues received through export of oil and the consequent appreciation of the exchange rate, all other economic sectors with the exception of oil have stagnated or declined. Also, as a direct consequence of the Dutch disease, an appreciation in exchange rate gives an incentive to oil rich countries to accumulate debt and borrow irrationally because of cheaper interest payments on debt, despite the fact they receive huge revenue through the sale of crude oil. Thus, when the prices of oil plunge downward (like during the oil glut of 1980s), oil rich debt ridden nations default on their debts or are forced to pay penalties which draws them further into the debt spiral. In this regard, a special mention must be made of Nigeria, which is one of the many African oil rich nations that is a victim of the resource curse, since it first came into wealth with the discovery of oil in the 1960s. It is observed that Nigeria had accumulated significant debt following the oil boom of the 1970s in order to finance its increasingly unproductive expenditure. There was growing indebtedness until the oil glut of 1980s led to a severe drop in global oil prices. Nigeria plunged further into debt and was forced to default. With a depreciation in exchange rate, the cost of living rose as most imported goods and services became expensive. There was a huge cut in the education and health sector expenditure along with sudden deterioration of social infrastructure.

High volatility of oil prices

Secondly, high volatility of the international prices of crude oil is another force that is responsible for perpetuating this anomaly or paradox by bringing about volatility in revenues for countries dependent essentially on oil for their inflows. Between 1960s and the first decade of the twenty first century, we had witnessed a series of oil shocks and oil gluts that had a debilitating impact on the global economy. The extreme volatility of oil prices lead to a severe distortion in the government planning and debt servicing process, and thus hampered economic growth. Moreover, the sudden cuts in revenue due to the oil glut lead to curtailment of important economic and social programmes and welfare schemes, causing widespread unemployment and discontent among citizens along with a deterioration of the law and order situation and political instability.

Lack of diversification of resources

Thirdly, the practice of non-diversification of resources into other important core sectors of the economy such as infrastructure, manufacturing etc. is responsible for further exacerbating the economic condition of oil rich nations. These sectors require huge

investments and have a large gestation period, but nevertheless are extremely vital to boost productivity, efficiency and employment in the economy. Oil rich countries prefer to depend on natural resources like crude oil, which generates quick revenue but plays havoc during price slumps. One example is Nigeria, which like many other African nations is the proverbial farmer that consumes all the seeds and has nothing to grow. The huge wealth amassed by it through oil in the 1970s was not effectively channelized into creating a good institutional base that is required for proper growth of the economy. Revenue collected was not spent on education, banking, infrastructure and other financial sectors as it yielded less returns over a long period of time. Thus, the economy plunged downwards and an increase in oil revenue did not translate much into economic growth or development or improvement in the standard of living.

Moreover, the natural resource sectors provide the highest salaries for both skilled and unskilled labour, which prevents them from working in other institutional (government as well as private) productive sectors important for economic growth. In addition to this, there is also a serious depletion of human capital because the natural sector in majority does not require much education for its workforce, which is in contrast to other resource deprived booming economies of South Korea, Taiwan, Singapore and Hong Kong i.e. "the Asian tigers", which essentially depend on skilled labour force for growth.

Ethnic and international conflicts and government corruption

Lastly, nations with abundance of natural resources find themselves in the midst of several ethnic conflicts and at times civil war and international aggression. This is a given fact, for tribes and communities are likely to reach an impasse over control of resources and allocation of revenues as far as precious crude oil (i.e. black gold) is concerned since its distribution more or less tends to be inequitable. These events, along with the intrinsic underdeveloped stage the oil rich nations are in, further aggravates the problem because law and order is not strong enough to contain the uprisings, leading to political instability that hampers economic growth

In Nigeria, internal unrest and ethnic conflict has been in full swing since the 1960s, accompanied by a succession of military coups. The Niger delta (which is the principal oil producing region) has become a site of intense struggle between the local population and the government, where the locals have all taken up arms and formed a militant group called the Movement for the Emancipation of the Niger Delta (MEND). This group fights against the inequitable distribution of oil profits between foreign companies that reap the rewards of oil resources and the local population that continues to become poorer. The conflict in the Nigerian basin has taken a toll on oil production through excessive oil spills and a discontented labour force.

Angola is yet another oil rich country embroiled in civil unrest due to the separatist movement over Cabinda (a northern territory of Angola that accounts for two-thirds of the total oil production and contributes $5 billion dollars to the gross exports earnings). The clash in the Cabinda region is a result of discontentment among the locals who believe that they have been deprived of their share of oil and are not getting enough through their endowments.

Also, there is always threat of international aggression by hegemonic nations who may want to establish control over the oil fields. In contemporary times, many view the US invasion of Iraq in 2003 as a means to establish control over the Caspian basin,

which connects many pipelines between Europe and central Asia. Moreover, there is tendency of oil rich nations to instigate international conflicts, which is popularly called 'petroagression'. The Iraq-Iran war in 1980 and the Iraq-Kuwait war in 1990 give testimony to this fact.

There is also a problem of immense government corruption with little or no accountability that worsens economic conditions. The government of oil rich nations does not depend upon taxes for its revenue needs and mostly meets them through the export of crude oil and hence, remain, by and large, unaccountable. Through its control over crude oil, it serves to amass huge wealth, which it then uses to thwart and suppress those (i.e. the civil servants and voices of citizens) that challenge its power and position. According to a report published by Transparency International (2007), the OPEC oil rich nations rank very poorly in the corruption perception index.

Thus, by citing the examples of Angola and Nigeria, enough practical evidence has been given to support the oil curse thesis or the fact that abundance of resources has a negative impact on the democratic regimes and economic growth of an economy. However, in the recent years, we have seen countries like Norway successfully escape the clutches of resource curse. This is not because the theory of resource curse is not ubiquitous, but because Norway had the foresight to recycle its oil revenues into other sectors of the economy and indulge in rationale economic measures. It also had a good leadership together with a functioning democracy and a competent bureaucracy that further provided impetus to its economic growth. Thus, even though Norway might be an exception, the oil curse theory is necessarily a rule, particularly as far as poor, politically unstable, underdeveloped countries are concerned.

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BITCOINS

Shubhi Singh
III Year

Invented in the wake of the global financial crisis by a mysterious computer guru using the pseudonym Satoshi Nakamoto, bitcoins are a form of cryptography-based e-money. They can be stored either virtually or on a user's hard drive, and offer a largely anonymous payment system.

Currencies serve multiple functions in society, but primarily they are used as a medium of exchange and as a store of value. In principle, bitcoins can fulfil both those roles for its growing community. As long as businesses choose to accept bitcoins in payment and there are exchanges to turn them into other currencies, they will survive as a medium of exchange. While

bitcoins started as a response to the financial crisis and an attempt to circumvent the shortcomings of our global financial system, they have quickly turned into a growing economic force and a unique test-bed for new ideas about money, value, and ways of buying and selling.

Bitcoins crashed in China in December 2013. Beijing keeps a tight grip on Yuan, and enforces capital controls, which the e-currency threatens by its very nature. In December 2013, the People's Bank of China banned domestic third party companies from providing clearing services for virtual currency. On the other hand, various US government agencies have said that bitcoins offer legitimate benefits. They believe that bitcoins provide an amazing platform that will change the way the world understands money.

But Indian bitcoin companies are on the fence regarding continuing operations. It cannot be denied that bitcoins and other virtual currencies have begun to gain widespread acceptance in India, despite poor internet penetration and a natural scepticism to assets not backed by tangible entities such as land .The RBI has stated that users of virtual currencies are exposed to potential legal, financial and security related risks. It has, in fact, issued a notice warning the public of the risks involved with virtual currencies such as losses arising out of hacking, no established framework for recourse to customer problems and the general financial volatility surrounding bitcoins, while claiming that they could be used for money laundering and funding terrorism activities. It stopped short however of issuing a ban or any other restriction.

It is a known fact that in India, the creation, trading or usage of virtual currencies is not authorized by the central bank or monetary authority. It has also been reported that bitcoins are being traded on exchange platforms whose legal status is also unclear. Hence, traders are exposed to legal risks as well. But leading legal and taxation expert Nishith Desai has given this cryptographic digital product a clean chit stating that bitcoins *per se* are not illegal in India, but how one deals with these may be a matter of legality. This is in consonance with the international approach. It is very important that this new technology be understood timely and an appropriate regulatory regime be developed so that India does not miss out on a great opportunity. Bitcoins may be highly risky now, but they can be an alternative to general currency as well as a major financial instrument in the future.

The government's job is to warn the public about the high volatility and risk propositions of bitcoins, but it should not create fear that bitcoins are illegal. Bitcoins are for those who have an appetite for high risk and who have faith in this technology.

Bitcoins look like currency or money, sound similar to securities or shares, feel like derivatives or negotiable instruments, but they are not so actually. They are not a prepaid instrument either. While in the US bitcoins are regarded as a commodity, it is doubtful whether it could be considered so in India as it is an intangible property. Bitcoin creation and transfer is based on open source cryptographic protocol managed in a decentralized way, and if harnessed properly, bitcoins could deliver many benefits to India's economy.

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China's one child policy

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The demographics of the People's Republic of China are identified by a large population. Chinese population reached the billion mark in 1982. Today China's population is the largest in the world. China is a nation with a long and fascinating past. From being home to the most advanced bronze working civilization of the ancient world, to the invention of gunpowder and fireworks, to the famous (and infamous) such as Confucius, Kublai Khan, and Marco Polo, and to the formation of the People's Republic, the history of China is indeed impressive. However, the fact that is given the most importance today is its one child policy.

In order to analyse the impact of China's one child policy, we first need to understand how it came about. In the 1950s, Mao Tse-Tung urged his people to have lots of children to strengthen the country. The resulting population growth gave birth to concerns about feeding the citizens in the 1970s. Hence, the Chinese government formulated the One Child Policy in 1979. The goal of this policy was to keep China's population below 1.3 billion by the year 2000. In order to ensure implementation, the government imposed a strict "family-planning policy" which limited most urban couples to one child and allowed two children for rural families if their first-born is a girl or born with any physical or mental disability. It also allowed two children for parents who themselves are each an only child. Those who did not qualify for an exemption and still gave birth to a second child had to pay an expensive fine, or "social maintenance fee", to keep their child. The policy was meant to help the impoverished country feed its people. China credits the policy with keeping family expenses down so that parents could more easily raise their standards of living.

According to many estimates, by 2050, more than a quarter of the population will be over 65. Demographer He Yafu says that the policy threatens to harm stability because the elderly segment of the Chinese population that is growing at a faster rate than previous years. Moreover, the leaders fear that the country's ageing population will both reduce the labour pool and exacerbate elderly care issues.

The All Girls Allowed group says that by 2050, China's population will be declining by 20 million every five years, and one out of four people will be over the age of 65. China's elderly population is 11% of the total population today; by 2050, it will be 31% of the population if the trend is not reversed. Most of the elderly in China are still cared for by relatives, and only children from single-child parents face what is known as the 4-2-1 phenomenon. When the child reaches working age, he or she would have to care for two parents and four grandparents in retirement.

China also needs more workers to maintain economic growth and generate tax revenues to care for a growing elderly population. China's working-age population, i.e. those aged 15 to 64, is drastically shrinking. From 2010 to 2030, China's labour force is expected to lose 67 million workers, more than the entire population of France, according to United Nations projections. Mr. Wang and other population experts have argued for several years that the

government was running out of time to change course. Birthrates have already fallen in some cities to levels below those needed to replace the current population. If left unchecked, the labour force would shrink, pressuring wages and inflation, and fewer workers would be taking care of a growing elderly population, potentially creating a pension shortfall.

Many Companies manufacturing or operating in China have already seen their profits diminish as the supply of labour, seen as China's most competitive advantage in attracting foreign companies to its turf, tightens, pushing up wages. The ripples of the policy change may be felt as far away as the fields and processing plants of the U.S. Farm Belt, which has already been shipping a growing share of its soybeans, pork and other products to feed China.

The one child policy has had several undesirable consequences. Similar to most Asian economies, Chinese society values baby boys more than baby girls because boys carry on the ancestral name, inherit property, and are responsible for taking care of aged parents. Because of these reasons, hundreds of thousands of baby girls are abandoned every year in China. The babies are abandoned in public places (such as busy streets, railway stations, and in front of public buildings) so that they will be found quickly. In addition to little girls, handicapped or sick babies (both boys and girls) are also abandoned because most parents in China don't have the money to provide for their special needs. Once found, the abandoned babies are given a medical exam and then taken to orphanages.

The traditional preference for boys has also led to couples opting for sex-selective abortions. By the end of the decade, demographers say China will have 24 million "leftover men" who, because of China's gender imbalance, will not be able to find a wife. Women are coerced into abortions, despite Beijing's denial of this phenomenon. In 2008, the last year in which abortion numbers were made available, 13 million abortions were done, according to the state-run China Daily newspaper. All Girls Allowed estimates that 10% of all abortions in China are forced. Although forced abortions and sterilizations are illegal in China, it has been observed that local officials sometimes force women to undergo such procedures to meet population targets set by planning officials in Beijing. This has made population controls a lightning rod for Christians and human-rights activists in the West. The issue took centre stage in US-China relations last year when blind legal activist Chen Guangcheng, who exposed forced abortions in parts of Shandong province, escaped de facto house arrest and fled to the U.S. Embassy in Beijing, later arriving in the U.S.

China's one child policy has also made it an international centre where people turn to for international adoption. From 1983 to 2003, Americans adopted 40,496 children from China.

It has been often argued that the one-child policy has appeared increasingly out of place in a society where social mobility and individual freedoms have greatly expanded in the past decade. Tired of waiting for change, many better-off Chinese have had second children, either by going abroad to circumvent rules, or by paying hefty fines, causing popular resentment and drawing occasional criticism from the government.

Citing all these issues, last year, a government think tank urged China's leaders to start phasing out the policy and allow two children for every family by 2015, saying the country had paid a "huge political

and social cost". The China Development Research Foundation said the policy had resulted in social conflict, high administrative costs and a long-term gender imbalance.

In order to remedy this, the changes to the one-child policy and labour camps were part of a key policy document released by the official Xinhua News Agency following a four-day meeting of party leaders in Beijing. China is now loosening its decades-old one-child policy by allowing two children for families with one parent who is an only child.

However, many economists argue that the policy may not have as much of an impact as people think because living in the cities is expensive. Children expected to be born as a result of the policy shift will add modest growth. Population experts estimate 1 million to 2 million births over the next three years, starting at least 9.5 months from now at the earliest. These children won't enter the workforce for another 20 years.

"There's no exact optimum number to add," said Mr. Wang. The Shanghai government found in a 2012 survey that couples born after 1980 are willing to have only 1.2 children on average. The average number of children born per couple in the city is 0.7, well below the rate of population replacement, according to census data.

According to New York University economics professor Ann Lee, who specializes in China's economy, if a significant number of women do decide to have more children, it may create a labour shortage in the short term as women leave the workplace to care for the children. As China's economy strengthens, it will likely follow the path of Europe and the United States, where women following careers have fewer children and wait longer to have them. However, this change in policy may address the issue of China's status as the nation with the most abortions, including forced abortions and sex-selective abortions, which has caused unrest and skewed China's sex ratios.

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Regional trade agreements: building or stumbling blocks to global trade?

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III Year

People and economists started accepting the idea of free trade only after Adam Smith's 'The Wealth of Nations' in 1776 and David Ricardo's theory of comparative advantage. Trade reform has three approaches: unilateral, bilateral/regional

and multilateral. Out of these, multilateral and bilateral trade agreements have an advantage as they lead to greater trade liberalization, increase in market efficiency and encourage specialization among countries. Most countries now are moving towards regional trade agreements due to various reasons including the failure of the recent Doha round negotiations along with the inability of the WTO to liberalize trade in agriculture, textiles and apparel.

The following are the reasons behind countries opting for regional trade agreements (RTAs):

1. Dissatisfaction with the current multilateral trade regime

Frustration with the current multilateral trade regime is one of the main reasons for the growth of regionalism. Many countries find it easier to negotiate and deal with the issue of trade barriers on a regional or bilateral level. After the Uruguay round of WTO, countries are more concerned about global trade since most of the promises of the Uruguay round have not been kept. Expansion of trade in agriculture, textiles and services, particularly in the developing countries, has been quite dismal. Developing countries are moving towards regionalism because of the protectionist policies followed by the developed countries and their unwillingness to open up their markets.

2. Bandwagon effect of regionalism

The adoption of regionalism by USA has led to an increase in RTAs since 1990s. Developed countries such as the USA and the European Union are now becoming a part of free trade agreements with developing countries on a regional level. This has encouraged many developing countries to become a part of these free trade agreements so that they are not excluded from these markets. The countries which are left out form regional trade agreements among themselves. This, according to the economist Jagdish Bhagwati, creates a bandwagon effect where no country wants to be left out of some major regional groupings.

3. Other factors

Countries also form regional trade agreements due to various political reasons. Regional trade agreements help in building better relations among nations. Countries learn to cooperate and this reduces conflicts and leads to peaceful living. There is also a feeling of security among the members.

According to the World Trade Report, foreign direct investment is an essential source of foreign capital inflow. So in order to attract FDI, developing countries are going in for regional trade agreements. Developed countries like the USA and the European Union have formed RTAs with developing countries in order to take advantage of the benefits of investment and trade.

Economic impact

According to Viner, the net effect of trade liberalization is not always positive. He has coined two terms to explain this: trade creation and trade diversion. Trade creation takes place when inefficient domestic production is replaced by efficient products imported from countries that are a part of RTAs. For example, country A produces refrigerators at $140 per unit and there is a 50 percent tariff on refrigerators not produced within the country. Country B produces refrigerators at $130 per unit. If there is free trade agreement between the two countries, then consumers of country A can purchase a refrigerator for $130 and country A can stop production of refrigerators and produce something in

which it is more efficient. Trade thus allows for greater efficiency in production and lower consumption prices. Trade diversion takes place when a country imports high-cost products from partner countries instead of purchasing low-cost and efficient products from non-member countries. This reduces tariff revenues and essentially leads to subsidization of less efficient producers. Therefore we can say that trade creation increases a country's welfare whereas a trade diversion has the opposite effect. The net effect, i.e. whether a regional trade agreement is positive or negative, depends on which effect dominates the other.

However, countries should benefit from regional trade agreements since with removal of trade barriers, countries are able to purchase products at the cheapest rates from competitive suppliers, and this enhances efficiency and increases welfare. Also, if member countries are geographically closely situated, then they will be highly dependent on each other. Thus, trade diversion will be very low.

Trade diversion is likely to dominate trade creation, particularly when the countries of the RTA have small economies. In case of multilateral trade regimes, trade diversion will dominate trade creation. An important point to be noted here is that there is an assumption of full employment in trade diversion.

In March 1991, after signing The Treaty of Asuncion, Argentina, Brazil, Paraguay, and Uruguay formed a customs union called the Southern Common Market. The customs union is commonly called as MERCOSUR. It created a market which was integrated and the member countries imposed a common tariff on goods imported from non-members. Although Mercosur has been a major success and the value of trade among the nations has tripled, but there is a cost associated with RTAs relative to multilateral trade liberalization. Mercosur consumers are forced to pay higher prices for certain imports and advanced technology is unavailable for their use. As a result, their incomes are falling and economic growth is also slowing down. Hence, it can be said that Mercosur has produced a considerable amount of trade diversion.

In 1989, Canada and United States implemented a free trade pact called North American Free Trade Agreement (NAFTA). In 1994, they broadened the agreement to include Mexico. Since NAFTA has come into effect, trade among countries has more than tripled. Foreign direct investment inflow in these countries has increased tremendously and Mexico has become one of the largest recipients of FDI. There has also been a rise in the employment rate in North America. 40 million jobs have been created since 1993. NAFTA has led to greater market competition and provided countries access to advanced technology, investments and materials. This has stimulated economic growth in North America. Thus, it can be said that NAFTA has led to trade creation and has had a positive impact on the welfare of the nations and the people.

Conclusion

The benefit of RTAs is largely because of the favourable impact they have on trade creation. However, the underlying assumption that there is full employment and that there are no economies of scale does not exist in countries today. Trade creation may result in loss of livelihood and employment for a section of the population, although the consumer will get goods at cheaper rate. For example, in Mexico small producers and peasantry lost their jobs. Similarly, trade diversion may provide some employment opportunities in periods of

recession, as happened in Mercosur countries. Therefore, we cannot have a doctrinaire approach and say that regional trade agreements are beneficial or detrimental to global trade. Each regional trade agreement will have to be assessed individually in terms of its impact on trade creation, trade diversion, employment opportunities, economies of scale etc.

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Economies of Trust and the Financial Crisis

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Trust makes the world go round. It is the most pervasive cultural characteristic influencing a nation's prosperity and its ability to compete. Trust enables people to do business with one another, which in turn creates wealth. Trust and growth are positively related and are mutually reinforcing in nature. If the society's levels of confidence and trust are low, it leads to inefficiency of markets and institutions, causing the economy to settle in an inefficient equilibrium in a multiple equilibria model of growth.

As critical as trust in both government and business is for our political and economic system, faith in other people maybe more important. Trust in other people, or generalized trust, is a central factor in shaping both social cohesion and institutions that function well. The roots of generalized trust and confidence in institutions are not the same. Confidence in institutions largely reflects current performance of the economy. Moreover, confidence is less variable than trust in government.

A crisis of confidence portends a loss of public trust, and there is no better example of this than the American banking industry that bred the global financial crisis of 2008. The financial crisis, originating from monetary excesses, caused a housing boom followed by a bust which eventually threatened the total collapse of financial institutions. Banks ultimately had to be bailed out by national governments. Stock markets around the world also witnessed a downturn.

From 2000, the Federal Reserve started easing the lending standards and held its target interest rates well below monetary guidelines. The Federal Funds rate fell by 11 times, from 6.5% in May 2000 to 1.75% in December 2001. This created a flood of liquidity in the economy. It was cheap money which was easy prey for restless bankers and borrowers who had no income, jobs or assets. The complex interplay of subprime lending and adjustable-mortgage lending lead to exuberant risk taking due to

availability of loans at low interest rates without any down payment. The environment of easy credit coupled with a large demand for houses lead to the appreciation of home prices. This upward spiral in prices made investments look like a new rush for gold. The Fed, too, continued slashing interest rates (in June 2003, the Fed lowered interest rates to 1%, the lowest rate in 45 years). To make things merrier, in October 2004, the Securities Exchange Commission (SEC) relaxed the net capital requirement for five investment banks (Goldman Sachs, Merrill Lynch, Lehman Brothers, Bear Stearns and Morgan Stanley), which allowed them to leverage credit upto 30 or even 40 times their initial investment.

Trouble soon began as interest rates started rising and the demand for home ownership reached its saturation point. The Fed started raising the funds rate, and by June 2006, it had reached 5.25%. Incentives for investment in housing soon dried up, and this lead to a fall in housing prices. The U.S. Home Construction Index declined in 2006 by 40%. Not only were new homes being affected, but many subprime borrowers could not withstand the higher interest rates. They started defaulting on their loans and filed for bankruptcy.

It became apparent in August 2007 that the financial market could not resolve the subprime crisis on its own. The financial crisis became acute and interest rates rose dramatically. Policy makers misdiagnosed the crisis as one of liquidity rather than of counterparty risk. The Economic Stimulus Act of 2008 was introduced, whereby a package of cash totalling over a $ 100 billion was given to individuals and families with the aim of jump-starting consumption, and by extension, the economy. But this failed too. The Fed started slashing the discount rate as well as the funds rate, but bad news continued to pour in from all sides. Lehman Brothers filed for bankruptcy, Indymac bank collapsed, Bear Stearns was acquired by JP Morgan Chase, Merrill Lynch was sold to Bank of America, and Fannie Mae and Freddie Mac were put under the control of the U.S. federal government. The crisis was now being aggravated by governance failure: political governance by regulators and legislators, corporate governance by firms and executives, and personal governance by individuals.

The consequences of the crisis

The crisis resulted in either people losing their homes or the value of their houses sinking below the mortgage they were paying. A household's expectation of potential earning power declined substantially. The number of unemployed climbed to 14.7 million over the course of the recession, peaking at 10 percent of the nation's labour force in October 2009. The ranks of the underemployed (those who want a job but can only find part-time work) and frustrated job seekers (those who become discouraged and give up looking for work) rose to 12 million, a 94 percent increase. In July 2013, four years after the recession is deemed to have ended, labour underutilization remains intractably high: 11.5 million people are unemployed and an additional 10.6 million are underemployed or frustrated.

The crisis also resulted in a significant loss of trust in government institutions and the U.S. capitalist economic system. Saving the system from complete collapse, especially with extraordinary government assistance, including bailouts to a handful of giant financial institutions, reinforced the perception that public support exists primarily for large, interconnected and complex financial entities. Deemed "too big

to fail," these financial intermediaries lacked discipline, accountability and transparency, and proved largely immune to the downside of their excessive risk taking.

People also felt betrayed by businesses that they saw as playing fast and loose with financial instruments that few seemed to understand. Investment firms took excessive risks using resources that either had deteriorated greatly in value or had never existed at all.

The fact that financial markets could come so close to collapsing has given citizens a glimpse of the fragility of modern finance and its strong dependence on mutual trust. For any economy to function, the participants must trust that the system is reasonably fair. Trust between individuals is a reciprocal behaviour. The system would fail to function if there is a lack of trust on either side.

Hence, a question now arises as to how the financial industry can rebuild its image. Building institutional and industrial trust is not easy. One way to do so is through performance. Once investors begin to recoup their losses and the market rebounds, any concern or hostility towards the industry will likely dissipate, at least temporarily. In fact, we are already seeing evidence of the beginning of this process. However, relying solely on performance to build and sustain public trust can be risky, as industrial performance is often cyclical, and in a downturn, the chance of losing the public's confidence can be high.

For the financial industry to be perceived as trustworthy, ethical and high performing, especially in light of the financial crisis, it must develop the capacity to respond to and learn from experience and generate positive outcomes. The financial system must act in accordance with a set of core values and beliefs, which should be aligned within and across firms. Another critical component in the trust rebuilding process is creating a sense of positive intent towards the stakeholders of the industry. Positive intent requires that the industry should be clear in its motives and communicate the same to its shareholders. When there are common values and goals, customers and clients are more willing to believe that a firm or industry has their best interest at heart. When there are no mutually held values or expectations, there is a perception of imbalance in power, along with greater risk and vulnerability, which prevents trust from flourishing. The financial industry needs to focus on these aspects and regain the people's trust quickly, so that it can contribute to greater growth.

Developing Real Economies in Synthetic Worlds

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"In the cyber universe, though the worlds are synthetic, the economies are real. Cyberspace is ruled by the law of supply and demand, which quantifies prices exactly as happens in the real world," observes the Italian economist Loretta Napoleoni, known primarily for her analysis of terrorism finance networks. In her book Rogue Economics, she turns her attention to Chinese counterfeiters, Russian oligarchs, Congolese slave traders and other

'globalisation outlaws', who deeply influence the production and distribution of everyday consumer goods. Among her subjects are the workers of 'online sweatshops' and virtual currency moguls who contribute to internet-based entertainment industries, the turnover of which rival the GDP of several countries in the world. Online gambling and multi-player gaming may appear to be industries which are too sleazy or frivolous to illuminate core issues of economic development, but I attempt here to demonstrate how it is that these sectors, and their similarities with other internet-based industries, illuminate several concerns integral to development economics. Further, these sectors also reflect the different paths chosen by China, India and South Korea in understanding and achieving development.

Napoleoni wrote her book in 2008, prior to the social gaming and gambling app industry explosion, which are forecasted to cross $ 100 billion in profits by 2016, but which rely to a great extent on the actors who built the online industries charted out in Rogue Economics. Estimating the number of the workers involved in this 'internet-based cultural sector' would not take into account the informal sector where a substantial number operate. A better estimate would therefore be from the supply of such products and services to online platforms and direct consumers, and in this regard China and South Korea fare exceedingly well. Napoleoni partially attributes China's success to its much criticised trade policy, and notably its 'flagrant disregard of intellectual property', something which India has a better global reputation for. It could be, therefore, that the reason why China claims more producers of 'under the table' secondary market currencies for internet gaming is because there is no fear of violating copyright restrictions of the companies which produce and license such games. In addition to trade policy, China's domestic laws also appear to be more tolerant towards 'immoral markets' such as gambling than India's. Thus, ultimately, in a trade-off between reputation and long-term development policy on one hand, and short-term economic growth on the other, China appears to have opted for the latter. While this appears to be an explanation behind the discrepancy between developing countries' immediate earnings from such sectors, this is not the whole story. Interestingly, such industries were not substantially affected during the economic crisis, and despite a slight decline in the funding of new products, there was no lapse in overall demand and turnover. Thus, they appear to be less vulnerable than other export-driven products and services of developing countries.

But what is yet more interesting is that China and South Korea are important contributors to the internet-based creative and design sectors as well, where India lags behind immensely. This could be attributed, in part, to infrastructure and to the number of internet users. As per World Bank estimates, around 38.3% of China's population are internet users, as against India's 10.1%. However, in absolute terms, India has more internet users than Hong Kong and South Korea, both of which earn far more from the design and creative sectors. Another indication of how infrastructure in terms of internet access may not explain participation in web-based platforms is the decision to introduce Spotify (a hugely successful commercial music streaming service, where, for a relatively small monthly fee, one can access an enormous music library as well as publish music) in Hong Kong, Malaysia and

South Korea, but not in either in China nor India, where internet users have a sense of entitlement to free music. While belief in copyright may be a more ideological issue, what cannot be disputed is that the business model followed by music distributors and producers has changed dramatically across the globe, and platforms such as Spotify are often integral to the popularity and earnings of new unknown artists.

While trade policy and infrastructure are undoubtedly explanatory factors in the Asian demographic distribution vis-à-vis earnings from internet-based cultural sectors, I have tried to show that such factors do not provide a comprehensive causal picture. This is further highlighted when contrasted against India's liberal attitude towards the bitcoin, which is a trading system that has been shown to support anonymous transactions in drugs and gambling. Thus, though the Supreme Court has declared online gambling to be illegal in India, it appears to be tolerated when it comes to gambling implicitly through the usage of bitcoins. Hence, India's sophisticated financial sector has managed to take advantage of bitcoins, but other sectors like the formal creative sector and the informal technological sector lag behind their Asian counterparts.

The lesson to be learnt from Napoleoni's analysis is that though the connection between online sectors and potential earnings is incontrovertible, but given the fact that these sectors operate as 'rogue markets' means that there is relatively little scope for regulating them meaningfully to secure alignment with specific development policies. As countries like China appear to have developed a robust informal internet-based human capital pool, they are able to take advantage of such markets. It is a sustained interest in immoral markets that may in the medium or long-run lead to the development of human capital, whereby there is more engagement in the production of secondary goods and services than consumption of such problematic products. Given that the morality of internet transactions cannot be controlled, as evidenced by the bitcoin, it would make sense for India to concentrate on equipping its population with sophisticated literacy catered towards internet-based products and services, and perhaps rethink how intellectual property protection adds to economic development. Since online gambling can still be conducted by Indian internet users using bitcoins, it appears that only direct internet gambling is illegal. Taking a leaf out of how China deals with uncontrollable informal internet earnings, India could apply sound economic reasoning to understand how informal users of illegal online markets such as gambling could use their inevitable participation and hone it into capital.

Policies based on morality or legality regarding the working of the newer internet-based sectors may not meaningfully add to the formalisation of the informal sector, which is an integral part of development. It is, thus, essential for policymakers to understand how these markets operate and how they contribute to the informal sector in particular and economic development in general. While policies may view these markets as temporary, they indeed do form tougher and more durable economies, which are very much real.

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UNCONVENTIONALLY YOURS

Bailout Economics

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Post the Second World War, the economies of most European countries were shattered. Taking advantage of this situation, the Soviet Union of Russia began influencing them both ideologically and politically to accept communism as an economic system. To contain this spread, the US which viewed communism as the biggest threat to free world came up with the Marshall Plan. In accordance with this plan, it started doling out funds to the weak European countries to help them out of their precarious economic conditions and away from the grasp of Russia. Behind this apparent altruism lay the objective of obstructing the growing power and strength of Russia. During the four years that the plan was in operation, the US spent more than $15 billion helping countries like Greece and Turkey among others.

However today, in the 21st century, the greatest threat a country might face is the threat of terrorism. It has almost become imperative for every country to allocate a fraction of its budget for funds required to counter this menace. While countries like the US, England and even India can afford to spend large amounts to combat terrorism, smaller countries like Pakistan, Bangladesh and others just cannot do so. It is in economically weak countries like these that the threat of terrorism is even higher.

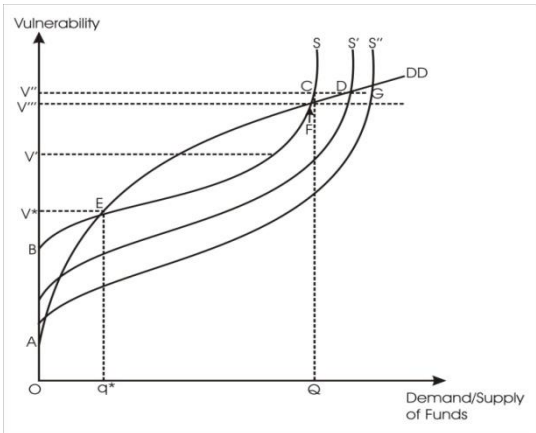
Since 9/11, American policymakers have significantly increased military as well as non-military assistance to Pakistan in an attempt to address their strategic concerns as well as to support their democracy. U.S. annual bilateral aid in totality went up from $5.3 million in 2000 to $798 million in 2002 to more than $4.4 billion in 2010. More than two-thirds (68 percent) of the $20.73 billion worth appropriated assistance over the past eight fiscal years has gone to security-related aid.

The above-cited examples clearly point to the fact that there exists a symbiotic relationship between a superior economy (in this case US) and the inferior economies. While the inferior economies need considerable aid for reviving themselves from a possible breakdown, the superior economy acts as their saviour and comes to their rescue, which is a means to address their strategic interests.

Now the questions that strike our mind at this instance are- 1) How much aid will the supreme country provide? 2) Will the inferior economy be able to improve its situation?

If not, then what happens to that economy? To answer these questions from an economic perspective a simple model is constructed to capture the behaviour of both economies.

It is assumed that the economic conditions in the superior country are more or less stable, instability in the inferior country has a considerable impact on the superior country and that the funds are efficiently used by the inferior economy for the assigned purpose. Consider the following diagram: -



Let X be the superior country and Y be the inferior country. On the vertical axis we plot the vulnerability of Y. Vulnerability implies the instability or disturbance caused by a crisis situation in the inferior economy. It is measured by the loss in GDP of that country due to such disturbance. On the horizontal axis we plot the demand of funds by Y and the supply of funds by X.

Up to point A, Y can handle any disturbance on its own beyond which it will have to rely on external aid. The demand for funds is positively dependent on the level of vulnerability of Y. Moreover, as vulnerability rises, the demand for external aid rises at an increasing rate as can be seen in the above diagram where the inverse demand function plotted is thus concave.

Now X, because it is a powerful country, would not be affected much by an initial increase in vulnerability of Y. But after a critical level B, it will be induced to tackle the problem and hence the supply of funds is dependent on the level of vulnerability of Y. Also, as vulnerability rises, supply initially rises at an increasing rate (X will try to urgently fix the crisis), and after a point it starts rising at a decreasing rate, till it becomes vertical or inelastic at point Q (the exogenous upper limit to the aid given by X). Again, by plotting the inverse supply function; the supply curve will first be concave, then convex and finally vertical.

Equilibrium, in this model, would imply equality between the demand and supply of funds such that vulnerability remains stable i.e. the situation does not worsen even if it does not improve. We have two equilibrium points E and F. Note that E is a stable equilibrium because any divergence from E will lead to a movement back towards E. For instance, at any vulnerability level slightly greater than E, the external assistance to mitigate the instability is greater than what is demanded by Y. Hence, with time, Y will recover and its vulnerability would come down. On the other hand, by the same logic, F is an unstable equilibrium. E is also a 'good' equilibrium because with a relatively lower aid (q*), X has succeeded in stabilizing Y with vulnerability at a lower level (V*).

Starting from V*, if there is a shock in Y (a sudden crisis), then vulnerability abruptly rises to a level, say V'. Since at this higher level, the supply of funds exceeds the demand, therefore, over time, solely X's aid will bail Y out of the crisis. But, if it so happens that a massive crisis hits Y then vulnerability will suddenly shoot up to a very high level, say V". At this level, Y is demanding more funds to deal with the crisis than the maximum that X can provide, i.e. point Q. Due to the paucity of funds, the situation aggravates further as vulnerability keeps on increasing. Thus, unless X increases the exogenously determined maximum aid, Q, the future of Y is at stake.

It is at this critical juncture that the role of international bodies like UN, IMF and World Bank is appreciated. These organizations can be instrumental in coming "to the rescue" of Y by providing a grant equal to the differential, CD, between the demand and supply of funds at V". As a consequence, the combined supply curve of external aid (that provided by X plus that provided by the IMF or any other international body) shifts rightwards by CD (new supply curve is S') and vulnerability will be stabilized at V". Thus, an imminent danger of the collapse of Y will be mitigated.

Moreover, if these world financial organizations grant an aid, which is slightly greater than CD, say CG, then the combined supply curve of external aid shifts further towards the right (say S"). With the new supply curve (S") and the existing demand curve (DD), at V" the supply of external aid now exceeds the demand resulting in a fall in vulnerability over time. Thus, in the long run, Y's situation will significantly improve.

At this point what needs to be answered is that 'for how long should the IMF continue providing aid to Y?' The answer would be that once vulnerability falls below V"' (the level corresponding to the earlier unstable equilibrium, F), the IMF can start phasing out it's aid. This is because once the level of vulnerability is pushed below the unstable equilibrium level; it will automatically come down to the good equilibrium E. In this manner, international organizations play a crucial role in "bailing-out" inferior economies from crises.

The above model, with certain modifications with regard to the definition of vulnerability, can also be applied to the problem of "credit crunch" in commercial banks. Banks make profits by lending at a higher rate of interest than that paid to the depositors.

Ideally, banks would like to "borrow short-term" at a low rate of interest and "lend long-term" at a higher rate of interest. However, banks have to be able to meet their customers' demands for cash at any point of time or else there would be what is called a 'financial panic'. The liquidity ratio is the proportion of a bank's assets held in liquid form (cash, balances at the central bank, short-term loans and government bonds with a year to maturity). Banks therefore have to balance their desire for profitability (requiring a low liquidity ratio) with the need to avoid a financial panic (requiring a high liquidity ratio).

In this context an example of Northern Rock, which was UK's fifth largest mortgage lender, can be cited. It became a prey to the "credit crunch" as it had grown by raising increasing amounts of finance from the short-term money market and lending it for long-term mortgages. In September 2007, Northern Rock obtained emergency financial support from the Bank of England. Thus, it became the first bank in over 150 years to suffer a bank run and was ultimately nationalized in February 2008. Hence, in this regard the role of the central bank of a country as the "lender of the last resort" is akin to the role played by IMF in the context of the earlier model.

The inferior countries necessarily need to ensure that there are no lapses on their part as far as the interests of the superior economies are concerned .The US deferred nearly by $800 million in counter terrorism funding to Pakistan in July 2011, which was followed by the US raid on Osama bin Laden's hideout in Abbottabad. However, this is not an isolated incident, arrest of a CIA contractor in Lahore and assassination of a Pakistani journalist (allegedly involving the ISI) further fuelled tension in an already sour relationship. The United States alleges that Pakistan is unable or rather unwilling

to take decisive actions against militant groups attacking its troops in and around Afghanistan. Thus, withholding aid was the only logical step available to them.

The over simplifying assumption of the efficient utilization of funds by the crises ridden economy was the driving force of the above model. Unfortunately, its validity seems to be highly questionable in reality. As they say, 'Beggars can't be choosers'. Hence, it is in the interest of the inferior country to ensure that there are hardly any lapses and certainly, no mismanagement of funds.

The Economics of Love

Upasana Majumdar
III Year

During the Valentine's Day week, everything is packaged and painted in the colours of love- from discounts on diamonds to couple passes in clubs. Love, therefore does play a role in encouraging consumption and driving the economy, but is there any economic principle that could drive love?

The real subject of economics isn't supply and demand, but people, and to love liberty is to love people and all that is best in them. And it is something that can only be done when we are free to choose. As our fine professors of economics tell us, economics is the study of the allocation of scarce goods and services. What could be scarcer than true love? It is rare, hard to come by and often fragile. At heart, the study of economics is all about maximising utility or ''happiness''. It is based around the premise that left to their own devices, individuals will come together to make mutually beneficial trades.

The market of love

It was an American economist, Gary Becker, who first began extending these principles from markets for goods and services to the market for potential partners. He argued that the market for love and marriage was like any other, with individuals coming together to make mutually beneficial trades and to sign a contract ensuring future beneficial transactions. And because individuals compete for mates, a truly competitive market for marriage partners exists. Assuming there are benefits from marriage - a stable relationship in which to care for children for example - there are risks from leaving marriage too. As more people couple-up, the pool of potential partners diminishes. But perhaps, grandma is right- "if you don't find "him" when you are young enough, chances are, you won't find him". Hence, don't shop around for a mate forever as there will only be a diminishing pool to choose from. Go with someone with the "highest weighted average" of the qualities you are looking for...!

Now that it is decided to get down with this business, given below are the costs involved:

Transaction costs involved in searching for a partner - all those flowers, phone calls, gifts, dinner dates etc.

Opportunity costs - All the fun and hobbies forgone because of being in a relationship.

Sunk costs - All the investments on the person which are lost if it does not work out, in other words, the ' break-up' costs.

If the relationship gets serious, then

remember, marriage is a long-term investment. Choose someone who you think would make a good business partner to avoid the replacement cost for another partner. To get the relationship started, a proposal game is explained below:

The Proposal Game

Suppose the person required is found.... finally! But, who would bell the cat and say the 'L' word first. A game theory analysis of the same yields a very interesting result.

Why no one wants to say 'I love you' first

Game theory: This theory helps you decide on the "best course of action following your other game partner's choice" – with one important caveat: it doesn't necessarily yield the 'best' possible outcome, just the most logical.

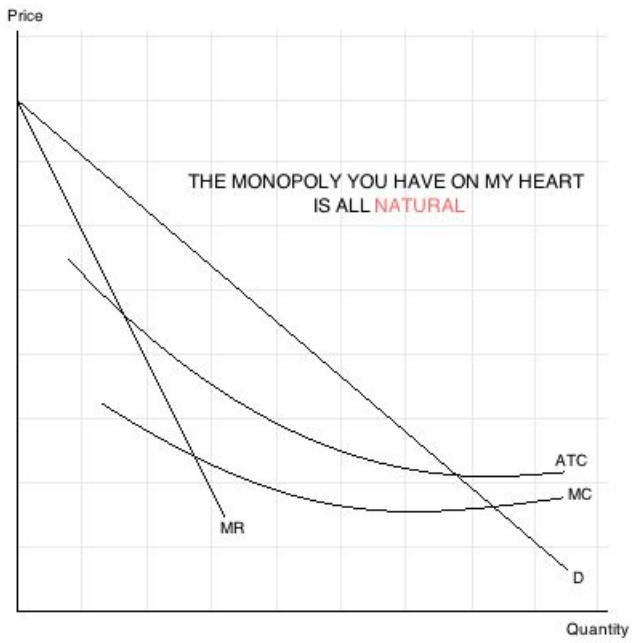
	Partner says I love you	Partner stays silent
You say I love you	Romantic bliss	You feel rejected
You stay silent	Partner feels rejected	Dignity intact (Dominant strategy)

So for example, in the case of whether or not to say 'I love you' in a new relationship, according to Nobel-prize winning economist John Nash, the dominant strategy (i.e. one that leads to minimal loss no matter what the other person does) is to stay silent (lest one person confesses their love and gets rejected). Even though the "best possible outcome" is actually for both parties to take the plunge and say how they feel. Thus, dominant strategy is indeed the safest.

Monopoly benefits

The matters of the heart are truly an area where all is well if there is a monopoly of a single person in your life. Perfect competition (i.e. having a large number of people vying for your attention) would yield zero profits, whereas, higher the monopoly power, more is the profit in this market.

In every long-term romantic situation, returns are greater when there is a monopoly. If you have to share your love with others, the whole thing falls apart. You want to have monopoly bonds with your long-term partner. At least most situations work out better this way. In other words, I conclude that cheating will end the game (Cheating=game over).



Thus, I assume that for the sake of the game, neither of the two partners will cheat on the other. When it comes to deciding whether to stay or go, economists say we shouldn't be held back by 'sunk costs' – in other words, losses that have "already been incurred and cannot be recovered". One of the most common reasons for staying in a dysfunctional relationship is the fear of "losing everything you've invested" in it. But in doing that, argues Smith, we are missing

out on the future opportunity of happiness. Thus, I conclude: Try your best to make it work. But if you are the only one trying, then it's the shut down point.

Disclaimer: This article assumes that all humans are 'homo economicus' i.e. in all possible situations, given the constraints, they would maximise their benefits. For all those, for whom love is replete with all the Yash Raj Films mushiness, a heartfelt apology, if this article hurt your sentiments.

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High Taxes in the Name of Charity

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According to the Black's Law Dictionary, a tax is "in a general sense, any contribution imposed by Government on individuals, for the use and service of the state, whether under the name of toll, tribute, duty, custom, excise, subsidy, aid, supply, or any other name ." Libertarians consider taxes to be a form of organized theft by the state. Socialists, on the other hand, defend the imposition of taxes on the account that they are necessary to reduce inequality in the society. Monarchists call taxes a "necessary evil". They argue that the state should exist only to protect its citizens from theft, aggression, breach of contract and fraud; therefore they are in favour of minimal taxation imposed by the state on its citizens.

What about those taxes which are imposed on the society in the name of the greater good? Welfare schemes such as universal health care, unemployment benefits, distribution of free laptops to students, financial aid for single mothers, and free education to minorities etc. are all financed by the taxpayer's money. Everybody feels morally obligated to help others but should they also be legally obligated to do that? Should the state have any right to force people to help those who are less fortunate?

Let us consider 3 scenarios. Suppose, a man 'X' has bought 10 apples from the market and he is going back home .On his way he meets a person 'Y'.

SCENARIO 1: Y snatches the bag of apples from X and runs away.

SCENARIO 2: Y tells X: There is an old man who sits outside the temple. He has not eaten anything for 2 days. Can you please give him two or three of your apples? He might be very hungry and has nowhere to go. Everybody in the society is doing their bit to help him. You can donate anything in cash or kind.

SCENARIO 3: Y tells X: There are so many people who need our help. You must give three of your apples to me so that I can help such people who can't afford even two meals a day. If you don't give anything, I have the authority to take away all your apples. You can also be imprisoned for not giving anything.

In SCENARIO 1, X has been robbed. Y is a thief. Y would never come in front of X again for the fear of being handed over to the police.

In SCENARIO 2, X is being persuaded to donate. Y is a social worker. X can believe that Y will genuinely help the old man. Even if he comes to know that whatever he has donated hasn't reached that old man, he can stop donating to Y and can help the old man himself.

In SCENARIO 3, X has been taxed. Y is a tax collector. Y would order everybody in the society to pay a specific amount according to his/her income and would collect taxes from them repeatedly. If X finds out that whatever he has paid has been misused by Y and has not reached the needy, he cannot do anything about it. No matter what, X has to pay taxes or else he would be punished as per the law.

In 'The Theory of Moral Sentiments', Adam Smith wrote: "How-so-ever selfish man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it."

Everybody sympathises with the sufferer though their degree of sympathy may differ. Persuading somebody for help is the only ethical way to receive it. Help cannot be demanded, it can only be asked for. Charity is a voluntary act of giving. If it is taken by force, then we are not donating, we are paying taxes.

Intrinsic motivation refers to the desire of doing something based on the enjoyment of the behaviour itself. Human beings are intrinsically motivated to donate to charity either due to pure altruism or warm glow (Andreoni 1989, 1990). A pure altruist only wants to help people, whereas a "warm-glow giver" donates in order to feel good about himself. He feels that giving charity earns him respect in the society and also raises his self-esteem. On the other hand, extrinsic motivation refers to the desire to perform so that the outside rewards can be achieved or punishment can be avoided.

Many people donate their blood at the Blood Donation Camps. They are intrinsically motivated to do so. They feel satisfied and there is always a 'feel-good factor' associated with donating blood to others. They only care about the fact that they are helping somebody in some way.

Suppose the Government imposes a law stating that anybody who meets the minimum requirements for blood donation, has to give blood once in every three months; this being done because the state wants to distribute the blood collected in such a way that nobody suffers from anaemia and everybody gets an equal opportunity to live a healthy life. In such a case, blood is being 'taxed' for the greater good of the society.

The state will be extrinsically motivating its citizens to donate blood i.e. if they don't give blood, they can be punished as per law.

Is such a law acceptable? While following this law, will these citizens feel the same as they would have felt if they would have donated blood voluntarily? Would they still be intrinsically motivated to donate blood to others?

The 'over-justification effect' is the effect of giving somebody an extrinsic incentive to do something that they already enjoy doing, thereby decreasing their intrinsic motivation to do it.

If this theory is applied, then it is clear that people who are forced to pay high taxes in the name of charity, do so to save themselves from being penalized by the State and are less concerned about the

morality and significance of the act of giving.

The Game Theorist in the Dark Knight

Kodali Tanmayee
III Year

The Joker's (with reference to the movie "the dark knight") final act as a criminal mastermind involves two ferries filled with people. The first ferry is filled with normal, law-abiding citizens while the second ferry is filled with the inhabitants of Gotham Prison. The Joker, without having prior knowledge of the passengers and city officials in the two ferries, wires the ships with powerful explosives such that their detonation would destroy the ships and everyone who is aboard. No single individual is allowed to escape. Each ship is given a detonator for the other ferry. The use of the detonator saves the ship while killing everyone aboard on the other ship. Thus, if any member of Ship A pushes the detonator, then Ship B is destroyed and Ship A is saved. Additionally, if either ship fails to use the detonator to destroy its opponent (i.e. each other), the joker will destroy both ships. Assuming that the actors must make their decision simultaneously, the following game would result:

Figure 1: Joker's Ferry Game

		Ship B	
		Cooperate	*Detonate*
Ship A	*Cooperate*	0,0	0,1
	Detonate	1,0	0,0

Solving this game is pretty straightforward, and (detonation, detonation) becomes the dominant strategy as cooperation is weakly dominated. Thus, passengers on both ships have a very clear strategy to, destroy their opponents without fail and in doing so; both ships will be destroyed.

However, in Gotham City (the fictitious city in the movie), this does not happen - nor would it necessarily happen in a laboratory experiment even if few more complications are introduced into the game. First, the game appears to be pseudo-sequential or, perhaps, a series of simultaneous game with a finite end. The Joker gives both ferries 30 minutes in which they can detonate the other side. Even with this complication, the outcome should be the same and both actors ought to choose detonation at the first node. Using backward deduction, both players recognize that their opponent will choose to detonate in the final iteration even if there are some gains in short-term cooperation. In other words, if they cooperate then both the ships can remain undestroyed for at most 30 minutes, thus mutual detonation is the ultimate result.

Decision Rules—"Social norms"

It appears that the decision making process for both ships is different. In the ship containing prisoners, the decision to detonate is decentralized and any one actor willing to grab the detonator could do so. However there are armed guards in the ship as well which gives the contrary impression of authoritarianism. Decentralization becomes apparent as the clock ticks. Thus, decentralized decision-making should lead to optimal play as any single individual among the 500 has a preference for survival.

On the civilian ship, the decision mechanism becomes a simple majority vote. Yet, there is no executive to carry out the decision and the will of the majority does not prevail as no single sub-actor is willing to push the button. The civilians act rationally as long as they can individually and are not directly involved in carrying out a potentially immoral act.

Morality?

Perhaps social norms mattered for the actors in the game? In the second game, we can assume that there are some social benefits from being a moral agent; however, being moral is not as beneficial as being alive. Since survival trumps morality, we get the second game:

Figure 2: Joker's Ferry Game; Survival > Morality

		Ship B	
		Cooperate	*Detonate*
Ship A	*Cooperate*	1,1	1,2
	Detonate	2,1	0,0

The pure strategy equilibria is {cooperate-detonate} and {detonate-cooperate} with a Mixed Nash Equilibrium of playing cooperation and detonation with a probability of 0.5 for both players. The specification would change depending on how we parameterize the value for being moral and the value for surviving. However, this is not the full specification of the game; let's assume that the parameters allow for morality to trump survival:

Figure 3: Joker's Ferry Game; Survival < Morality

		Ship B	
		Cooperate	*Detonate*
Ship A	*Cooperate*	2, 2	2, 1
	Detonate	1, 2	0,0

Then the pure strategy Nash equilibrium is to never detonate as cooperation is always more beneficial than destroying the other ship. While both specifications may be able to explain the movie, I think there might be a fourth game that explains the game the best.

The Joker misspecified his Game?

While it is not the moral of the story that Batman wants the Joker or Gotham City to learn (in fact, he says that people are not all evil - there is some good in Gotham), adding an additional parameter to the game can easily induce a cooperation solution. If the people aboard both ships believe that the cost of dying is probabilistic, then they would cooperate as long as the benefit to cooperating trumped both the probabilistic chance of punishment and the likelihood that the other ship decides to detonate. Thus, each ship has to calculate the value for morality (m) minus the cost of punishment P(c) and the cost of the other ship defecting P (dx)(d) where x is the other actor. The cost of opponent defection and punishment are the same (the value of survival), so the equation reduces to:

$$U(\text{Ship A}) = M - (Pc + P(dB))*(S)$$

$$U(\text{Ship B}) = M - (Pc + P(dA))*(S)$$

Each equation must still be greater than the value of Survival Minus the Cost of morality such that for Ship A (or B with appropriate substitution): $S - M < M - (Pc + P(dB))*S$

If M = S, then the joint probability of punishment and opponent detonation must be less than 1 for cooperation to be preferred, else defection dominates. As M and S vary in relation to each other, the threshold for the joint probabilities to make a preference in strategy also changes. Here,

if the value for M is zero for the observed actor and survival is infinitesimal greater than 0, detonation dominates. Likewise, if we build in opponent morality into the probability of opponent detonation, and opponent morality is zero, then the cost of morality becomes too high. Obviously, the game becomes increasingly complicated, as these parameters are made endogenous.

The actors must determine a subjective probability of the game being false (i.e. there may be incomplete or incorrect information given to them by the joker, hence they need to figure out such things by themselves): may be, the probability of punishment is not 1. The probability of punishment could go down from a 100 per cent if the passengers believe that the Joker is lying about the deadline and if they think there is a chance of technological failure such that their detonator may indeed destroy their own ship (adding a hidden cost to detonation), or if they live in a world with Batman. I would venture forth to assume that the probability of punishment is inversely proportional to the probability that Batman exists with some modification based on his likelihood of failing to save people -- but that is just what I think me.

There are a few other circumstances in this movie that can be subject to game theory applications and I have not exhausted the ways in which this game could be modelled. However, I think this calls for a new villain in the third movie of the trilogy, "The Game Theorist", who will be more of riddler, but probably deadlier, and will compel Batman to use mathematics to fight crime.

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Costs and Benefits of a College Dropout

Deeksha Trehan
III Year

"Whenever you find yourself on the side of the majority,
It is time to pause and reflect." ~ Mark Twain

Larry Ellison of Oracle, Bill Gates and Paul Allen of Microsoft, Mark Zuckerberg and Dustin Moskovitz of Facebook, Michael Dell of Dell Computers, Brian Dunn of Best Buy, Anna Wintour of Vogue, Barry Diller of IAC, John Mackey of Whole Foods, David Geffen, Ralph Lauren and Ted Turner. What is the common thing among these people? They are successful. What else? Yes, they are among those business leaders who got their starts without the benefit of degrees. We all know the story of Steve Jobs, who dropped out of Reed College. Even David Plouffe, senior advisor to President Barack Obama and architect of his innovative and historically unprecedented campaign, dropped out of the University of Delaware to work in politics (returning to complete his degree in 2010). President George W. Bush's top adviser, Karl Rove, and John McCain's 2008 campaign manager, Steve Schmidt, also lacked degrees. Examples are profound that prove that a degree or two from college may not be a necessary condition to achieve monetary success in life. Some would call these cases exceptional. Well, all of them? So, here I attempt to find a pattern in these unconventional realities of success. The article carries the assumption that we are taking into consideration factors other than

inheriting property from parents or using the same as the start-up capital or even as back up. Further, just to avoid any misunderstanding, few 'if' and 'then' cases need to be clarified. One, we don't assume that dropping out of college is a necessary or even a sufficient condition to become successful. Secondly, being a college-dropout-turned-successful-entrepreneur is just a subset of being a successful entrepreneur; that is, leaving college or being thrown out of college aren't the only ways to achieve success. Here we look at the cases say mentioned above. Recognizing this does not negate the importance of a college education -- the intellectual knowledge, access to a wide array of subjects and experience gained on a college campus can be transformative.

As commonly quoted, the causality in the correlation is explained by the conventional nature of a typical college degree saying that it restricts new thoughts, new ideas as one is expected to adhere to the strict norms say, the prescribed text, already-announced-exams based on the texts or attendance in classes. Wondering ~~of~~ what would have led these people to drop out from college made me make a list of all the costs and benefits that would have occurred to them while making the decision (doesn't apply to non-wishful dropouts!).

Costs

For a person to decide whether to leave college or continue with the degree, there are several kinds of costs that play decisive role in the case. Firstly, there are explicit costs of college dropout: one, it is the loss of degree one could have got had the drop out decision wasn't made; unable to acquire the degree results in lower unemployment rates overall and the obvious consequence of neither getting a job in the short run nor getting endowed with some sort of back-up to rely upon if nothing works right; two, the opportunity cost i.e. the cost of the next best alternative, equals the benefit that would have been implied by a job/work/activity pursued other than dropping out of college, like the benefit of doing a less paying job or just hanging out around with friends for few months. Unbearable effects of an unpaid student loan would make the matters worse! Secondly, besides the monetary costs, there are implicit costs that need to be taken into account: (a) time spent (wasted) in, say, bringing up the idea of a workable start up, (b) cost of uncertainty about future: No backup to rely upon, no inheritance to feed on and of course, no income to survive by!, (c) societal pressure not to drop out- friends, parents, relatives, acquaintances, everyone would come and suggest their ways of achieving success and the 'darkness before dawn' dialogues.

Benefits

Business is nothing but the execution of a brilliant idea. The idea need not sprout within the binding walls of classrooms or laboratories. It finds its birth in the creativity and the ardent desire to innovate. Dropping out of college gives the time and energy to think big and implement bigger. The inner being is happier while, the outer being is still coping with the long list of costs. With no compliance with the scheduled tests or strict deadlines, there is scope for trial and error. May be, the world would witness the birth of another Edison! When predictable curriculum gets boring, exploring divergent worlds might be a dream come true and natural curiosity takes form.

Which way to go? : The spillover effect

The decision so crucial might even be laughed upon by many because the discussion is just considered to be futile by

them as what other than a degree fetch you a decent job? Well, world would have simpler if that was the end of the story. Interestingly, it is not! Because the world is dynamic and so is the human mind, bubbling with curiosity. For the person who is to make the decision, costs might be very high at times. But like a lottery, say, if it works, will do wonders: not only to the entrepreneur but to the world as well. Do we sense a spillover effect here (?) Lottery for the individual and spillover for the rest of the world! Jobs faced the costs and we use iPhones years after! Not so sure what was the common idea that occurred to all these successful personalities at different times, what is certain that the idea emerged from the freedom of thought and constant inspiration without getting bogged down by the costs.

For the world to prosper, we probably need many more budding entrepreneurs who have the courage to think the different way. Maybe, among the list of the college dropouts every year in every college, there's a Jobs or a Gates who leads us to yet better lives!

FROM THE EDITORS' DESK

Taste Vs Health

Aditi Singh and Deeksha Trehan
III Year

Ever faced the difficult decision of choosing between a MaharajaMac burger (yummy, right?) and a vegetable soup? If you choose the latter, you must possess great courage and willpower! The choice between tasty-but-calorie-rich food items on the one hand and healthy-but-distasteful dishes on the other is undeniably a difficult one and is something we face every day. Yet, more and more people are giving in to the desires of their tongue which is evident by the increasing obesity levels. According to the World Health Organisation (WHO), worldwide obesity has nearly doubled since 1980. In 2008, more than 1.4 billion adults, aged 20 and above, were overweight. Of these, over 200 million were men and nearly 300 million were women.

Obesity is defined as abnormal or excessive fat accumulation that may impair health. It is the fifth major cause for global deaths. At least 2.8 million adults die each year as a result of being overweight or obese. In addition, 44% of the diabetes burden, 23% of the ischaemic heart disease burden and between 7% and 41% of certain cancer burdens are attributable to obesity. Once considered a high-income country problem, overweight and obesity are now on the rise in low and middle-income countries, particularly in urban settings.

The fundamental cause of obesity is an energy imbalance between calories consumed and calories expended. Globally, there has been an increase in the intake of energy-dense foods that are high in fat and arise in physical inactivity due to the increasingly sedentary nature of many forms of work, changing modes of transportation, and increasing urbanization.

The consequences of obesity can be very severe leading to increased risk of cardiovascular diseases (mainly heart disease and stroke), diabetes, musculoskeletal disorders (especially osteoarthritis - a highly disabling degenerative disease of the joints), hypertension, insulin resistance and psychological effects.

We now attempt to explain the above phenomenon through the microeconomic tool of game theory. The game is played between two players: myself, and everyone else. Each player can either choose to eat tasty but unhealthy foods or unsavory but healthy dishes. We assume that there does not exist any good which satisfies the mantra of “Taste bhi health bhi”, that is, all healthy foods are unsavory while all unhealthy/junk foods please the tongue. We further suppose that junk food makes you obese, while healthy food helps you stay thin.

Game 1:

In this game, we try to explain the trend of rising world obesity. This occurs because people give more weightage to instant pleasure than long-term benefits.

The payoffs of this game are as follows: If both the players eat junk food, then they obtain momentary satisfaction by enjoying a mouth-watering meal and hence the payoffs are 3, 3.If I eat junk food whereas everybody else eats healthy food, then I get a payoff of 3 whereas others get a payoff of 2. The opposite is true if I eat healthy food and everybody else eat junk food. If all of us eat healthy food, then we get displeasure by eating distasteful food, but this is slightly offset by long-term health benefits we receive. Hence, the payoffs are 2,2.

		EVERYONE ELSE	
		Junk	Healthy
MYSELF	Junk	**3,3**	**3,2**
	Healthy	2,3	2,2

In this case the Nash equilibrium is (Junk, Junk).

Game 2:

In this game, we introduce a third factor that we call 'social consciousness.' Apart from the above mentioned benefits, now there is an additional utility from the consumption of healthy foodstuffs as they help one to stay slim. Staying fit has various advantages such as increased confidence and self-respect, ability to look good in the clothes we wear and gaining social acceptance. Others also seek our company more frequently.

The payoffs of the game also get altered accordingly. Now if both the players eat junk, then they get a payoff of 3 each, which is again due to the momentary satisfaction gained from scrumptious food. If both eat healthy food, the payoffs are 4(=2+2), which is a sum of benefits gained from being disease-free (2) and those from staying slim (2). But now, if I eat junk and everybody else eats healthy food, then my utility of 3(acquired through the consumption of tasty dishes) gets reduced by a factor of 2, since my utility declines when I see others fit and myself obese. My net payoff, thus, is 3-2=1. Everyone else's utility is 4, which is the utility from eating healthy food. The reverse occurs when I eat healthy food and everybody else eats junk food.

		EVERYONE ELSE	
		Junk	Healthy
MYSELF	Junk	**3,3**	**1,4**
	Healthy	4,1	4,4

So in this case, the Nash equilibrium is (Healthy, Healthy). The fact that everyone is healthy is more optimal from the society's point of view since everyone is able to enjoy the benefits of being hale and hearty.

Hence, we observe that when people give more preference to instant gratification, everybody eats more junk food which is a sub-optimal outcome for society. But if people become more conscious, then we can arrive at a situation where everyone eats healthy food and stays fit. We recognize the fact that the assumption that no healthy food is delicious may not be true in reality. Nevertheless, the model does depict the trade-off that one faces in a lot of real world situations. Hence, here we propose raising the level of social consciousness as a solution to controlling the rising world obesity levels. Even though people may be aware of the benefits of eating healthy food, yet they may often succumb willingly to the temptation. Yet if there is a strong social cost of being obese in terms of low

confidence level and social seclusion, then people will have a greater incentive to stay fit and the trade-off will align in favour of healthy food items.

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Small Scale Industries Vs Multinational Corporations

Debasmita Padhi (II Year) and Falak Arora (I Year)

The main motive of the Indian policymakers in the wake of the recent financial crisis in India has been to attract FDI (Foreign Direct Investment). This move is expected to put the Indian economy back on track. No recent debate on Indian development is ever complete without the mention of multinationals and foreign investment. It is vital to analyze then, this aspect of Indian policymaking. When domestic investment and savings doesn't meet the required rate of growth in the economy, the gap in investment is filled by the MNCs' investment. When the targeted foreign exchange is not met by the net foreign exchange derived from imports and exports together with net public debt, the gap is constituted by MNCs' net exports and capital inflow. They fill the gap between targeted government tax revenues and locally raised taxes as well as the gap of management skills, entrepreneurship and technological skills. However, there is a need for meticulous examination before hailing these big daddies of the corporate world as the panacea for our nation's economy. MNCs provide capital and savings but they charge a higher interest on capital borrowed by the government in the host country. MNCs repatriate the profits to their home country hindering the re-investment possibility of those profits in the host country. Further, MNCs import the required intermediate goods without purchasing from domestic producers, thereby reducing the opportunity to grow for the domestic producers. Even the tax policies are liberalized for these companies.

An argument in favour of these multinationals is that they help provide competition to local small scale industries and help improve their quality. While it may be true in some cases, the fact remains that multinationals have greater power. Power in the dual sense- market power as well as political power!! The large scale campaigning for some major political parties is financed by these big-shots and these parties in turn return their favours by providing quick approvals and clearances. These companies then begin to dictate to some extent the policies adopted by their host nation. What kind of one-sided competition are we then providing to our local industries?? Aren't we furthering a monopolistic structure by wiping out our very own "kirana-shops" with these giants?? In the US, small retailers that once served the middle classes could not match Walmart's much lower prices. The Indian retail market is different. These locally owned, small retailers keep their prices low because they use only the cheapest possible casual labour and invest next to nothing in their stores. Prices cannot get any lower. In India, Walmart can compete only by offering higher prices — and better quality to attract the middle-class consumers who are able to pay. Who is willing to shop for

grocery in the open when you have air-conditioned stores providing you so many "offers"??

The local industry is facing stifling competition. It is constantly being badgered to innovate and adopt new strategies to stay in the business. We talk of these cottage industries specializing in niche products. They make pickles, bangles and agarbattis, provide services like repairing automobiles and cellphones etc. Relegating these activities to the small scale industries is acceptable provided big Indian companies have a presence in the formal sector as well. The Indian industry needs to take the challenge head on by exploring markets that they these multinationals have a stronghold in. A very good example is the Micromax Company which has carved a market (22% share) for itself in the past few years in the smartphone sector.

Yet another unquestionable facet of the story remains that small scale industries are indeed indispensable engines of the economy. Especially in a country like India which is entrapped in problems ranging from dire poverty, unemployment, crumbling infrastructure; small scale industries have had a huge role in ameliorating these spheres. SSIs contribute almost 7.2% to the Indian GDP. Especially for budding entrepreneurs, SSIs have low capital requirement and are thus a favoured route to set up their businesses. With the coming in of much larger and powerful MNCs, SSIs undoubtedly have faced unprecedented competition. Even with the odds tilted heavily in the favour of MNCs, SSIs haven't exactly vanished from the face of earth! Tradeoffs do take place, in some case enough to shut them down while in other they find their own safe waters to float on. The biggest advantage that MNCs gain over SSIs is their heavy bank accounts! They advertise more rampantly and are much more in the public domain. In such a scenario, it is hard for the SSIs to make their presence felt. Despite all this SSIs continue to be a part of our economy due to many factors. There are certain products that aren't lucrative or profitable enough a battlefield for the MNCs to enter for example making matchboxes, incense sticks, Similarly goods that have high transportation cost and are thus produced only for the nearest markets, are produced on a small scale. Such goods are not a favourable destination for MNCs either. One of the ways for the MNCs to enter India is through the small scale industries. In such a case, the MNCs do not construct their own plant rather they engage a number of SSIs to produce the good according to their specifications. Through the means of outsourcing their demand they generate employment and give a more powerful role to the SSIs. For example on the label of many consumer products you might have read 'manufactured by' a local plant in India while 'marketed by' the parent company. A visit to big bazaar might remind you of the range products made by them, sold alongside those of other companies. These again are outsourced to small manufacturers. Even when none of the above cases apply, SSIs continue to survive and persist. For example take the case of Nirma detergent, with the coming in of big players like surf, Ariel etc it went through a stifling time. But it adopted a unique marketing strategy and emerged a winner. Today it is one of the market leaders in the lower end of detergent sector. So while there is a trade off, it hasn't completely written off the small scale industries. As C. K. Ranganathan of Cavinkare puts it, "What is required to take on MNCs is the 'Can Do' spirit. I have heard many Indian firms saying that they can't take on global competition as they had deep pockets etc. If

you have this mindset, you are already defeated".

But nevertheless when a shark enters, the small fishes are either displaced or eaten up. Similar is the case here. When large MNCs enter the fray, they do take away a lot from the small and medium players. They eat into their market share and thus subsequently into their revenue. So what's debatable is the extent of such a trade off, but that such a trade off takes place is undoubtedly a resounding yes! The Government's policy initiatives like enactment of the new Micro Small and Medium Enterprises Development Act, 2006, pruning of reserved SSI list, advising FIs to increase their flow of credit to the SME sector, are all initiatives towards boosting entrepreneurship, investment and growth. The government of host countries must have stringent regulations over the activities of MNCs. They should bargain for better deals and demand that MNCs adhere to certain criteria set by the government. While some survive and find ways to tackle the competition unleashed upon them, others give in. And eventually it is the economy that wins!

Political Pull Vs Economic Reasoning

Surbhi Ghai and Swaril Dania
II Year

"The first lesson of economics is scarcity: there is never enough of anything to fully satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics."
-Thomas Sowell

The disciplines of economics and politics constitute two different realms and their interaction might appear superficially inconsequential. However the larger truth is that in the context of a political system, there are two conflicting forces that necessarily influence development i.e. economic reasoning and politics. These forces, rarely in sync, interact and aim to satisfy the goals envisaged for development.

One such conflict exists between market efficiency and equity. According to Adam smith's concept of the 'invisible hand of the market' the economy can reach the state of equilibrium in the long run without any state intervention and hence, the market is fully efficient. This classical notion, which forms the backbone of major economic reasoning, is challenged by populist government schemes like subsidies, minimum wage which aim at equity but create artificial conditions in the market and situations of market distortions.

Policy making through economic telescope

1) Subsidies

Today, subsidies extended to any economic sector with an aim to promote economic and social welfare, have become an intrinsic part of government measures. It not only induces higher production and consumption and serves distributional goals but also help in correcting market failures. However, according to public finance economist Ronald Gerritse subsidies "may have externalities that we did not bargain for".

Subsidies create economic and market inefficiency by transferring resources from more productive to less productive use through sectoral allocation of the resources to the subsidized sector. It is also known to affect the fiscal budget by indirectly drawing resources away from the tax-

yielding sector to the less productive sector. Also black markets generated as a result of price control have contrary distributional effects of endowing greater benefits to well off people who can access the distributed good as against the poor people who face the brunt of shortages. However, contrary to economic reasoning, governments are unlikely to revoke subsidies as it may cause political agitation and evoke the displeasure of public.

Food security bill

The much hyped food security bill passed by the Indian parliament is an example of a subsidy measure that runs in conflict with economics and politics and has triggered much public debate. The ambitious bill envisages the distribution of wheat, rice and coarse grains at just Rs 2, Rs 3 and Rs 1 a kilo each to about 65% of the population. For fulfilling these promises the government plans to double the food subsidies to about 2% of GDP. But economists fear that such a policy would lead to disastrous outcomes for the Indian economy even though politically it would give leverage to the current government

According to the Financial Stability Report of the RBI, India's inflation risk remains high and slowdown in revenue collection and higher spending on subsidies may make it challenging for the government to achieve the fiscal deficit target of 4.6% of the GDP in the current financial year. Apart from the concerns about growing fiscal deficit due to large expenditures on subsidy, there are other serious issues about a widening trade deficit as well. It is expected that the government would resort to large scale import of food grains as the domestic food grain output is not adequate to handle such a voluminous expenditure programme which has a shortfall of about 70-80 million tonnes of food grains per year that will have to be met by imports.

Since taxes are not viable in the current economic scenario, another economic concern is that the higher expenditure will have to be financed through higher borrowing that could crowd out private borrowing. Also private sector would have to increase interest rates so as to compete with the government sector which is detrimental for the economy Moreover, since this is an open ended scheme with no expiry date or sunset clause, outlays would increase as the population grows thus inducing government to print money which would in turn lead to higher inflation. The problems associated with the procurement procedures also present a serious challenge before the economy. Food Corporation of India and the Central Warehousing Corporation together have the capacity to store 87 million tonnes of grain. The development of adequate infrastructure like storage houses for efficient functioning of the procurement system again requires a lot of expenditure. Also, there are issues about the diversity in crop production arising due to declaration of MSP for wheat and rice because this assured procurement gives an incentive to produce cereals rather than having a diversified production basket.

2) Price floors and price ceilings

Price floors and price ceilings are yet again another example of government measures that run in conflict with rational economics whereby they enact price control mechanisms if they believe that the market price of a good or service is unfair to buyers or sellers. The reason behind economists' scepticism over price controls is that they distort the allocation of resources. When government imposes a binding price floor it leads to creation of surplus, as sellers are unable to sell all they want at that price.

Similarly, price ceiling, if binding, results in the creation of shortages and contrary distributional effects. While price acts as the sole rationing mechanism in a free market, in a market with price controls and government intervention, there arises a need for several kinds of other rationing mechanisms that are often undesirable and inefficient.

Rent control legislations

Rent control legislations- a form of price control mechanism is the most effective example of government polices gone wrong by defying general economic rationale. According to Swedish economist and socialist Assar Lindbeck, "In many cases rent control appears to be the most efficient technique presently known to destroy a city—except for bombing." The statement sums up the general viewpoint of most economists about the rent control acts.

Rent control legislations prevent rent from reaching market clearing levels since given the market rent, if the rent dictated by the government is higher, the demand for housing exceeds the supply that would result in shortage. Moreover, with the shortages in regulated housing sector, the excess demand would spill over to the unregulated, non-controlled sector where black market would flourish. Rent controls have an adverse impact on investment in the housing sector as it reduces the potential for increased profits through regulation of prices. It also decreases the quality of dwellings due to reduced incentive for maintenance presented before landlords. In free markets landlords try to maintain the buildings well since desirable apartments can command higher prices. This incentive is lost when ceilings are imposed. So, although the ceiling protects the sitting tenant, he receives no real bargain because of improper maintenance of the apartments.

Minimum wage laws

The mechanism of minimum wage legislation envisions the accessibility of a minimum standard of living for all workers and is seen as a tool that protects them from exploitation of any kind. But it has come under great scrutiny because of the perceived ill effects that it has on the very people it aims to serve through job reduction. According to studies by Nuemark and Wascher, an increase in minimum wage by 10% can be expected to reduce jobs among a group of teenagers (less skilled group of workers) by about 1-3 %. This finds an explanation in the marginal cost and benefit analysis that goes behind the employment of an additional unit of labour.

An unskilled youth producing $4 worth of good in an hour would have a hard time finding a job if he must by law be paid $6 an hour since employers won't be willing to pay a worker more than the value of the additional product that he produces. Moreover, it makes unskilled workers more expensive relative to other factors of production. If skilled workers make $15 / hour and unskilled workers make $3/hour then skilled workers are five times as expensive as the unskilled worker but a rise of minimum wage to $5 makes them only three times as expensive as the unskilled thereby harming the unskilled worker. Contrary to this, some researchers assert that workers are not really paid their precise marginal product and hence we shouldn't expect them to be laid off because of moderate wage increase and hence the minimum wage effects on employment are small.

3) Employment guarantee acts

The MNREGA (Mahatma Gandhi National Rural Employment Guarantee Act) is the paradigm of the employment guarantee acts passed by the Indian government and has been defined as "the largest and most ambitious social security and public works programme in the world" It aims to provide 100 days of guaranteed employment to at least one adult member of the family every year in lieu of casual labour services. It is a highly populist measure that aims to provide an economic safety net for the rural poor. However like any other populist scheme MNREGA has been criticized on the grounds of economic non-viability and inefficiency. It has distorted labour markets and led to creation of labour shortages across all sectors specifically in the agricultural sector where there is increasing unavailability of labour for farm operations. Instead of enhancing employment it has substituted it and has led to increase in agricultural wages by almost 2.5%. Apart from the corruption due to leakages etc here is also the lackadaisical attitude of government administration whereby the workers are assembled for attendance and are let off with the day's wages without performing any or little productive work. With no funds for skill development and raw materials MNREGA's large potential for value addition to infrastructure has been squandered. Also, it is no secret that the MNREGA wages often end up at the local liquor shop thereby offsetting any foreseeable advantage of increase in wages. There is destruction of work ethic and promotion of dependency among the illiterate and unskilled population of the rural area.

In addition to this, MNREGA has been designed in such a manner that it has led to formation of sedentary population by containing India's rural population in the village. Thus, it has come under the radar of the World Bank, which describes this much hailed vote bank scheme as "policy barrier to internal mobility" in its World development report of 2009. Migration of villagers from rural to urban areas is considered important for poverty alleviation and full and better utilization of labour talent as villages cannot sustain large amount of unskilled labour. Thus, by inhibiting migration MNREGA is coming in the way of market driven economic development

Recently a proposal has been tabled in the Indian parliament to increase the wages under MNREGA. Thus, the government which stands to gain a dual advantage, is back to playing the cards that led it to win the previous general elections. If MNREGA scheme works it has a chance of coming back to power and if not then it will distort the economy to such an extent that it will take years for the new government to reverse the damage which could not be done without causing social unrest. The wheel will turn a full circle and the new government can be criticized for non-performance and the present government stands to gain.

Apart from these basic policies that form the crux of economic policy making, we also have inefficiencies in the transport sector as a result of conflict between economics of policy and politics. Every major country in the world today be it US, China or Japan, has a single integrated ministry of transport. Policies on various modes of transport i.e. roads, railways, civil aviation, ports; urban transport etc are not made in silos but integrated and coordinated. However in India political obligations perpetuate the practice of having separate Ministry for each mode of transport be it the ministry of civil aviation, ministry of railways, ministry of urban transport etc. These ministries formulate policies, which are not in sync

with other ministries and rarely consult each other. Economic reasoning suggest that we merge the ministries but political pull forces us to do otherwise even at the cost of inefficiency in the transport sector because India's political environment guarantees that 'all hell would break loose' were we to attempt the merger.

The naïve belief in noble intentions and ability of the government to bring about equitable, sustainable development is often misplaced, but at the same time, presence of market failure like externalities, public goods, monopoly and imperfect competition creates room for well designed public intervention to improve social welfare. We must recognize that good economics alone cannot guarantee good governance. Thus, the need of the hour is to recognize the conditions under which these forces run into conflict and attempt a balancing act wherein they are in synchrony with each other. We can ignore economics in public policy and politics in economic policy making only at its own peril.

BUZZWORDS OF THE YEAR

A Rollercoaster Ride for the Indian Rupee

Raavi Aggarwal
II Year

Did you know that the exchange rate of the Indian economy in 1990 was a mere Rs18 per dollar? Since liberalization in 1991, the Indian currency has depreciated significantly. This article explores the causes of the depreciation of the Rupee, the decline in India's growth rate and the subsequent reforms adopted to boost economic growth post 2010.

The unprecedented gross domestic product (GDP) growth rate of 9.3% in 2010-11 has diminished to a mere 4.4% in 2013-14. Consequently, the Indian rupee has depreciated from Rs 45 per dollar in 2010 to a staggering Rs 61.54 per dollar in January 2014. This can primarily be attributed to the weakening of industrial growth- the manufacturing and the agricultural sector both witnessed a decline in their growth rates. This was partially due to the tight monetary policy adopted by the Reserve Bank of India (RBI) in order to keep inflation and inflationary expectations under control. The RBI nearly doubled the repo rates in 2012 and, in effect, managed to reduce inflation rates. However, this resulted in a slowdown in economic growth. In 2013, it slashed Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR), which then created a disincentive for Foreign Institutional Investor (FII) inflows.

The Euro-Zone crisis and slow growth in advanced economies such as members of the European Union, the United States and China has also adversely impacted the Indian economy. Through dynamic linkages with the Indian economy, uncertainty in global trading nations has influenced Indian trade, with a noticeable fall in the exports and rise in imports. In 2010-11, the rate of growth of exports was 40.5%, which fell to an astonishing 21.3% in 2011-12, a decline of nearly 50%! A rise in domestic prices of petroleum, oil and lubricants (POL) as well as those of gold and silver contributed significantly to the increase in imports, thus widening the current account deficit.

Recessionary growth in the industrial sector, persistent inflation, subdued global financial markets and high crude oil prices had augmented the government budget deficit. However, not all was amiss. The government was forthcoming and pushed for immediate reforms when the Rupee plummeted to an all-time low of Rs 57.22 per dollar in June 2012.

The process of economic revival began with a series of reforms aimed at completion of infrastructure projects in major fields such as coal, railways, roads, power, petroleum, gas and so on. The Prime Minister Mr. Manmohan Singh outlined the process of reforms through the consolidation of both fiscal and monetary policy. Consequently, a 3-member committee headed by Mr. Vijay Kelkar, the Chairman of the 13th Finance Commission, was established to discuss

policy instruments to be used for fiscal consolidation. Furthermore, the Cabinet Committee on Investments (CCI), was also set up to fast track major investment projects budgeted above Rs 1,000 crores. The major objective of the committee was to smoothen the process of approvals and permissions that a project required in order to be implemented.

The most prominent reform adopted entailed a hike in petrol and diesel prices, slash in subsidies on LPG cylinders, reduction in fertilizer subsidies and liberalization of FDI norms. The Kelkar Committee predicted a reduction in subsidies to 1.8% of GDP 2014-15. The government generated revenues through a Rs 5 per litre increase in the price of diesel and capping of number of subsidized LPG cylinders to only one per household, along with a reduction of Rs 50 in their subsidy. In addition to a reduction in subsidies, the government fast tracked 209 major investment projects, with an approximate budget of Rs 4 lakh crores. The primary areas of focus were coal, power, roads, railways, petroleum and natural gas, steel, shipping and the aviation industry. Pricing policies for natural gas were modified, investments in oil increased and collaborations with Coal India Limited (CIL), the prime supplier of coal, were made. The power sector has remained the biggest beneficiary of the investments budget allocation, with 83 projects acquiring clearances towards implementation. Coal India Limited has signed fuel supply agreements, with over 18 coal mining projects having benefitted. Five oil and gas projects and 14 projects in steel, shipping, road transport and railways, have got the green signal for implementation.

In May 2013, gold and oil imports reigned over the Indian economy. The RBI, using its monetary policy instruments, issued inflation-indexed bonds, to curb gold and oil imports, thus contracting the current account deficit. These bonds provided a much higher return than regular bonds as they used the real interest rate (adjusted to prevailing levels of inflation), rather than the nominal interest rate. This tool of monetary policy acted as an effective measure to divert the public from purchase of gold and silver, towards public investment for the economy.

The government also targeted micro, small and medium enterprises (MSMEs), considering it a potential avenue for the largest scale of employment creation known to the Indian economy! It is estimated that 2,500 ventures would have been initiated by the year 2022. The CCI, along with the Special Project Monitoring Group (PMG) is set to resolve pending cases and complete the relevant paperwork to facilitate implementation of projects. This includes India's biggest ever FDI proposal- Posco's Rs 53,000 crores integrated steel plant in Odisha, which approached the Cabinet Secretariat in June 2013 for help in expediting clearances and land acquisition.

In January 2014, the Government of India signed nine pacts with the Korean Government, thus enhancing their bilateral ties. The government officials explored the possibility of constructing a Korean Industrial Park in India. This is an effort for India to not only boost its exports through ties with the Korean economy, which boasts of a trade surplus, but also to get integrated into the global supply chain. In the area of science and technology, a joint fund of US $ 10 million has been set up to finance several practical projects. A memorandum of understanding (MoU) on joint applied research has been signed by both the parties. Issues of Korean security, development in North-East India and Korea were also raised.

The Indian economy boasts one of the highest growth rates in the world. While the prime focus of the Indian government is on recouping the earlier growth and exchange rates, it must be done through the process of social inclusion and economic integration. India, being the second most populous country in the world, witnesses antithetical diversity- both culturally and economically. High saving rates provide a massive potential for public investment in the areas of education, technology, research and human development. The government ought to concentrate equally on both economic growth and development, as it is only when the per capita income of the country and the standard of living of its people increases, will the country be better recognized globally. Inclusive growth translates to a more equitable distribution of resources and a bridging of the gap between rich and poor. While the key challenges of alleviation of poverty, better education, health and indeed higher growth rates still persist, we hope to witness revolutionary reforms in the coming years!

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The Excruciating Cry of the Indian Rupee

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Mr Raghuram Rajan, the new governor of the apex banking institution of our country, has indeed brought about miraculous changes in the state of the Indian economy, but the Indian economy has been dancing to a very low tune of late because of the poor performance of the rupee. The rupee, as we all know, has given a very poor show in the past few months and there are umpteen number of factors responsible for it.

To begin with, the value of any currency depends upon the demand and supply of dollars in that economy. The demand for dollars in India has been continuously mounting whereas its supply is diminishing, which has led to excess demand and thereby the depreciation of rupee.

To add to our woes, the economy is dealing with two major deficits, the first being the current account deficit or CAD while the other is the fiscal deficit. Starting with the CAD first, the imports in our country far exceed the exports, which means more foreign exchange is needed by our country. This deficit is primarily because of the excessive import of crude oil and gold. Now, the other deficit is the fiscal deficit, which indicates that our expenditure is way ahead than our revenues, reflecting very poorly on our economy.

The above paragraphs tell us why the demand for foreign reserves is increasing, but along with it the supply of foreign reserves is also decreasing. The FIIs are

losing faith in the Indian administration due to a number of scams taking place and are gradually pulling out big chunks of their investment. This has also had a very bad impact on our foreign reserves, contributing to the depreciation of the Indian rupee.

But Mr Rajan brought a ray of hope with him and the Indian rupee has gradually started recovering. The dark clouds of despair are lifting and positive sentiments are building. He has initiated many reforms, including levying high import duties on gold, which has indeed reduced gold imports. As far as oil is concerned, it is a necessity and hence can't be done away with. Therefore, the oil importing companies have been granted easy access to foreign reserves so that oil can be imported with ease. Also, exports have been promoted to a very large extent. Due to this, the gap between exports and imports is gradually diminishing. FIIs have also been lured into investing in the Indian economy by ensuring transparency in transactions, which thereby ensures inflow of foreign exchange.

By adopting such measures, Mr Rajan has brought considerable positive changes in the economy. Vital signs of recovery are being observed and hopes are high that the rupee will soon regain its strength in the international market.

Weak rupee: Is it good, or is it bad for the economy?

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Astrologers say, "The Rupee symbol debuted on an inauspicious day and the horizontal line across the symbol appears to "slit the throat" of the currency".

-Washington Post, August 20, 2013

Introduction:

The period 2001 to 2008 was a golden period for India. The Indian economy witnessed a boom which made economists like Arvind Panagariya say "India – an Emerging Giant". Alas, since 2008, the Indian economy has been showing the signs of a lag. The growth rate slowed to 4-5%, just half of what it was during the time of the boom. Ever since we started encountering unfavourable macroeconomic environment, we started having problems like high inflation and widening current account deficit (CAD), giving birth to the depreciation of the Rupee which has been the cause of concern. A weak Rupee is also known as depreciation of the currency. It makes its presence felt in the economy when domestic currency becomes less expensive in terms of foreign currency. For example, if the equilibrium rupee-dollar exchange rate was Rs 56, and then it changes to Rs 68, we say that the rupee has depreciated against the dollar. The depreciation of the currency discourages imports but encourages exports. When exports are greater than imports, there is no current account deficit. Hence, many times

it is claimed that rupee depreciation is good for the Indian economy as it provides impetus to exports. This claim is supported by Pronab Sen, Chairman of the National Statistical Commission, who believes that depreciation of the currency has a positive effect on growth. But since it also pushes up inflation, ~~so~~ he advocates a tight monetary policy to control inflation. But this tightrope walk comes with a huge risk of falling, and the volatility in the depreciation of the Indian rupee this year has sent a warning signal that there may be something wrong with the economy.

Since the year 2009, the Rupee has depreciated not only against the dollar, but also against currencies like Pound Sterling, Euro and Yen.

Table 1: Exchange rate of rupee in terms of US dollar, pound sterling, euro and yen

Year	US Dollar	Pound Sterling	Euro	Yen
2009	48	75	67	51
2010	45	70	60	52
2011	46	74	64	58
2012	53	84	68	67
2013	62	101	84	59

Source: Handbook of Statistics on Indian Economy, Reserve Bank of India (RBI).

In 2013, the Rupee-dollar battle took an unimaginable, horrendous and threatening turn when 1$ = Rs 68, which sent a shudder down the entire economy. The rupee had depreciated nearly 20 percent in the year 2013. The economy, which was once growing at 9 percent and dreamt of ending poverty and diseases, found it difficult to grapple with this new reality. Though the fall of the Rupee was triggered by the external environment like ending of quantitative easing by the US, but domestic factors like ballooning fiscal deficits and rising CAD also lent a hand, and Mr. P. Chidambaram also accepted this. It was because of currency related disruption in the economy that the Economic Advisory Council to the Prime Minister forecasted the rate of economic growth at 5.3 percent (lower than the 6.4 percent in the April 2013 Review of the Economy Report) for the year 2013-14 in its September 2013 Economic Outlook Report.

Effects of Depreciation of Rupee on You and Me

1. Chain Reaction

Increasing output signals a booming economy to the investors, and this tends to boost share prices. Gavin (1989) believes that a booming stock market has a positive effect on the aggregate demand. Desislava Dimitrova (2005) believes that foreign investors will be unwilling to hold assets in a currency that is depreciating because the probability of gaining returns on investment is very low. If this is the case, then it leads to deceleration in the performance of the stock markets. This creates pessimism in the job market and low business school placements that reduces the purchasing power of Indian consumers (Employees in the job market are consumers at the end of the day), reducing aggregate demand in the economy. This reaction continues unless there is implementation of effective monetary and fiscal policy by both the RBI and government.

2. Rise in the Input Prices

Depreciation of the currency leads to a rise in input costs of producers. One of the most important inputs, which is highly inelastic in nature, whose cost rises because of a fall in the value of the Rupee is crude oil. India meets 75 percent of its crude oil demand

through imports. Oil companies pay for crude in dollars, and hence they will have to pay more money for importing oil, leading to high fuel prices. This creates an impact on the automobile sector as fuel alone account for 25-30 percent of the ownership cost of a small car in the year of purchase, according to CRISIL Research. Maruti, Mercedes-Benz, Hyundai, etc. have all hiked their prices because of higher input costs. This results in low sales volume and has been observed since 2011-12 onwards. High fuel prices also have implications on the airline industry which experiences huge cost challenges. Jet Airways, India's second-biggest airline by market share, has suffered a net loss of Rs 891.01 crores due to weaker rupee and high input costs.

3. Foreign Education and foreign goods remains a dream

With the weakening of rupee, it has become difficult for students aspiring to study in foreign universities and institutes to finance themselves. Most of the students take a loan for studying abroad. If the Rupee weakens, then they have to shell out more money. For instance, if they need $80000 to study abroad, in Indian currency they would require Rs 4000000 (1$=Rs 50). But now if the Rupee weakens to say $1=Rs 60, the money required increases to Rs 4800000. This is a sharp 20 percent increase, which creates a deep impact on their aspiration of attaining education abroad. Even foreign goods also become expensive, since we have to spend more money on each dollar.

Conclusion

The currency of a nation represents it's strength, image and buying power. If the currency weakens, it projects an image that nobody is interested in the business activity and goods of that particular nation. In that case, depreciation helps in correcting the trade imbalances. But trade imbalance will only be corrected if home country is exporting a good which is inelastic in nature and it has a comparative advantage in it. High inflation, large CAD and nervous investors around the globe have led to the weakening of the Rupee and that had adverse impacts like deceleration in stock market performance, rise in the input costs and greater Rupee requirement for the purpose of education abroad. Everyone in the economy is, in some way or the other, affected by the weakening of the rupee. Therefore, weak rupee is bad for the economy and efforts should be made to strengthen the economy by correcting the loopholes.

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