

Yuan talks

Revaluation Alone Will Not Suffice

THE good news is that the just-concluded US-China summit saw President Hu Jintao pledge to gradually change his country's exchange rate system. Many, especially US economists, believe the global imbalance is essentially because of China's recalcitrance and hence can only be addressed by that country not by the larger G-20 grouping. The bad news is that even a revaluation of the yuan is unlikely to work any miracles. For one, if Chinese growth is dependent on an under-valued currency, US growth too is dependent on cheap Chinese goods. Any revaluation of the yuan will, therefore, have macro-economic implications for both economies. In China's case there is the additional danger that a slowdown in growth could result in social and political upheaval.

For another, an appreciation of the yuan is at best a partial solution. China began pegging the yuan (at 8.27 per dollar) in 1997. But beginning 1 July 2005, it allowed the yuan to appreciate against the dollar and by April 10, 2008, the currency had appreciated more than 18%. This should have reduced the exchange rate advantage Chinese firms enjoyed. But Chinese exports continued to soar even as the US current account deficit rose steadily before declining slightly to \$706.1 billion in 2008. The US, moreover, runs a current account deficit with more than 100 countries, including very large deficits with Germany and Japan. If the exchange rate is the villain then these countries too must revalue their currencies. In truth the major explanation for the current imbalances between China and the US lies in the savings-investment gaps in the countries. China saves more than it invests domestically while the opposite is true for the US. The net result is a large current account surplus for the former and a deficit for the latter. US deficit is unlikely to shrink until the US swallows some of the medicine it happily doles out to others (courtesy the IMF) and tightens its fiscal and monetary policy. Till then it will be naive to expect a stronger yuan to work any miracles either vis-a-vis global imbalances or spell an end to the Chinese current account surpluses and the US current account deficits. Are Obama and Geithner listening?

Wind up Air India

National Carrier Should Be Privatised

THE strike by two unions of Air India barely three days after the tragedy at Mangalore was uncalled for, wrecking passenger schedules. Though the strike was called off on Wednesday, the troubles of the ailing behemoth go far beyond union scrapes. The national carrier's existence inconveniences passengers and wastes capital. The government should wind-up Air India. It must exit from the airline business that has many efficient players meeting the economy's needs without bleeding the exchequer. The reasons are compelling. The combined losses of the National Aviation Company of India (Nacil), formed by merging Air India and Indian Airlines (IA), were estimated at a staggering Rs 5,448 crore in 2008-09. Air India is also saddled with all the ills associated with state ownership. Political interference, policy inaction and patronage of vested interests have stifled the airline. The government should extricate itself from the mess rather than throwing in more money. Most countries have got over the idea of owning a national flag carrier. The world's big airlines are publicly listed with dispersed shareholding. India should follow.

The government should have a time-bound sale plan for Air India. It should redeploy resources in a new strategic sector that is beyond the capacity of the private sector. Air India will find buyers as it has assets to put on the table. The AI and IA merger was prompted by the dropping bottom lines of both, faced with competition from private airlines. But their balance sheet shows that two failed airlines have not made a successful unified airline. Sure, the aviation industry saw hard times during the downturn. High fuel costs coupled with the drop in air traffic dented the profitability of all carriers, including Nacil. But Nacil continues to flounder while other airlines have done better. Privatisation is the answer. Employee unions should be allowed to form a company and bid for the airline. A good buyer can transform the airline into a lean and viable entity that can be a shot in the arm for India's aviation sector.

End this paan-demic
Red Stains Must Be Contained

IT IS shocking that Kolkata's Howrah Bridge, whose famous cantilevered form rose even as war levelled much of Europe 60 years ago, is now falling prey to a corrosive red menace. It's a scourge that has already swept through much of India — particularly the central belt — but is still inexplicably regarded with indulgent disdain by those who matter. It is clear that until those telltale stains splash too close home for comfort, the Centre and state governments will never bestir themselves to take stern action to curb the hordes who perpetuate its spread in open defiance of all norms of civil society. In the current instance, not even the steel structure of the bridge over the Hooghly has been strong enough to withstand their repeated attacks on the very pillars on which it has rested for generations. What hope is there, then, for less robust entities? The finger of suspicion points to the thousands of people who cross the bridge on foot every day, rather than the 1 lakh-strong daily vehicular traffic as evidenced by the concentration of the onslaughts within spitting distance of the pedestrian-only section of the structure. But even the presence of posses of policemen and vigilant civilians do not seem to daunt these marauders, who take particular pleasure in destroying the grandest edifices and getting away scot-free.

The spreaders of this red menace are no doubt encouraged by their apologists among the intelligentsia, who uphold their deprecations under the specious plea of freedom of expression. Even as these ruthless chaps salivate at the sight of clean surfaces and bombard them with expectations of deadly accuracy, their supporters aver that the resultant red stains are probably the closest thing to paan-Indian public art we can boast of. State forces and civil society must join hands to put an end to this dangerous trend; mere post-facto clean-ups and whitewashing will not do.

Rules, regulations, user charges & taxes

The choice confronting governments is the appropriate mix of ordering devices which, in turn, depends on acceptance and enforceability that vary across societies, says Alok Sheel

MAN is a social being who, like ants and bees, or lions and elephants, aggregates together in large colonies or societies. This entails acceptance of a complex set of ordering devices to maintain social order, including regulating access to food and reproduction. In animals behavioral patterns are encoded in their DNA through a long evolutionary process. Human societies, on the other hand, have developed very rapidly since the Neolithic Revolution about 10 millennia ago. Man's unique ability to produce his own food has spawned complex social systems and civilisations based on orderly distribution, exchange and transfer of surpluses. Order in human society is enforced through the mechanism of the State.

There are four ways through which the State can ensure desired outcomes: rules/regulation, user charges, taxation and cajoling. The last has been the least used and researched mechanism, though this might be changing through the works of behavioral economists like Thaler and Sunstein who have made a compelling case for designing social and economic policies that incorporate an understanding of people's cognitive limitations and predilections encoded in their DNA. At the most fundamental level human societies are ordered through laws, customary or legislated, from which rules, regulation, user charges and taxes are derived, and even cajoling must be consistent with this corpus of laws.

Law in pre-modern society was usually segmented, reflecting the underlying social structure. Different rules governed different social segments. There was also a strong element of social dominance, or force, embedded in rules and regulations through which subaltern groups were subordinated through centralised State systems. Consider the set of rules informing slaves and masters, serfs and lords, primogeniture, patriarchy, caste etc. Contemporary laws, on the other hand, are universally applicable. Rules and regulations continue to be backed by force of course, but this force is now the monopoly of a centralised democratic State in whose



ZAHID ALI

eyes everybody is equal, although interest groups may nevertheless influence rule making and implementation, subject to the usual checks and balances associated with democracies. Transgression of the law is subject to State prosecution.

Regulation comprises a set of rules usually applicable to providers of specific services. Unlike laws and rules, regulations are applicable only to players engaged in particular activities, such as banking, insurance or motor driving. A rule or law, on the other hand, such as abjuring violence, is applicable to everybody at all times. Regulation also frequently has the effect of imposing additional compliance costs on players, although they may not always be easy to measure because it also has the effect of mitigating negative externalities, and hence involves complex cost-benefit analysis. Costs incurred through penalties imposed for non-compliance are easily quantifiable.

User charges are paid by consumer of a specified public good or service, calibrated to the quantity consumed, and the proceeds used to cover the costs of the good or service provided. While taxes can also be calibrated to the quantum of consumption, the proceeds are not normally utilised for covering the costs of the good or services taxed. User charges for power and water consumption depends on the quantity ac-

tually consumed. While a road tax may well be used exclusively for covering the construction and maintenance of roads, it differs from a user charge in that it is not calibrated to actual road usage. Both user charges and taxes can however be progressive, in that bigger and richer consumers pay higher marginal rates.

TAXES are based on a long-standing albeit unwritten social contract that in return the State makes available to its citizens public goods, such as law and order, national defence, and a whole slew of public services, although benefits availed by individuals may not be proportionate to taxes paid. In democracies, a gross violation of this social contract is likely to lead to change in government through the ballot box.

In view of the regulation — user charge — tax continuum, in several, but not all, cases the State has a choice regarding what instrument to use to attain similar outcomes. For instance, a water utility may charge each consumer for the water actually consumed at specified rates. Alternatively, water could be provided free, and the costs recouped out of general tax revenues, in which case some users may end up subsidising others. Where user charges are inadequate to cover costs, the deficit is eventually recouped from general tax revenues. In

other words consumers collectively — including future consumers, to the extent the deficit is financed through borrowings as opposed to current revenue/taxes — end up paying for the full costs of public goods. There is no lunch that is even partly free, although costs may be unequally distributed across space, time and individuals.

Likewise, regulation can be a proxy for tax. Thus, government can undertake social welfare measures directly through taxpayer resources, or mandate employers to undertake the same measures. While both mechanisms are in a sense tax funded, only the former expenditures actually pass through the budget. Trade-offs between regulation and tax inform current debates on climate change finance and financial stability. In climate finance, governments have the choice of either raising taxes to directly meet the costs of mitigation and adaptation, which are public goods, or putting in place regulation, such as carbon cap and trade regimes, that could fund the costs of mitigation and adaptation. Since carbon credits would not exist but for such regulation, they can also be considered a form of public finance. Financial stability has traditionally been addressed through regulation, including mandatory capital buffer to fund possible losses and failures. The recent financial crisis has underscored how fragile and procyclical financial markets can be and, with several financial institutions too systemically important to be allowed to fail, there are proposals to supplement regulation with special taxes to fund future bail outs of what are essentially public utilities.

It would be evident from the above that there is a continuum between rules, regulation, user charges and taxes, and divides between these are often blurred. Ultimately they are all alternative ordering devices to attain desired outcomes in human affairs. The choice confronting governments is the appropriate mix which, in turn, depends on acceptance and enforceability that vary across societies. Thus Americans hate taxes that expand the scope of State, something perfectly acceptable to Europeans, while Indians don't like to pay user charges. (The writer is a civil servant. Views are personal.)

Citings

THE NEW DEAL:
NEGOTIATIONS
Guhun Subramanian

IF YOU put aside fixed-price mechanisms, such as buying lettuce at the grocery store, negotiations and auctions are the only two ways in which assets get sold in any market economy. There's a deep literature on each of these mechanisms but very little on the interplay between the two — that messy, murky middle ground where most deals happen in today's world. The term itself, negotiation, is just a term — you can take it or leave it. But the phenomenon of across-the-table competition, as exists in a negotiation and also some side-of-the-table competition, as exists in an auction, is pretty ubiquitous in our increasingly competitive marketplace...

Another thing that's changing in the dealmaking world today is increasing price pressure, which often manifests itself through auction-like mechanisms. The subtitle of my book, *New Dealmaking Strategies for a Competitive Marketplace*, is a reference to this phenomenon. Companies are telling their marketing managers, "Get your advertising spend down by 20% over the next 12 months," and so the marketing manager then puts pressure on the advertising agency to lower its fees, sometimes with a threat of putting the business "out to bid." Yet if you focus solely on one metric, like price, you're potentially causing long-term problems. Something can be worked out in a more fluid process that isn't captured in a pure auction. The negotiation approach is a more nuanced mechanism that can result in a better outcome for both parties.

CHAT ROOM

Regulation helps

■ THIS refers to 'Don't blame the Greeks' (ET, May 26). Prof Joseph Stiglitz tells you clearly why the global economy ails, as far as the lay reader is concerned. And, he makes a telling point that "China will have to take a haircut on US debt" when he says that the dollar printing press is controlled by the US. And then, without mincing words, he tells when and why financial regulation is needed. After all, requisite regulation helps in ensuring that people's money, which is what "government

bailout" means even in America, is not lost, but is recoverable.

P KANAKA DURGA
BY EMAIL, MAY 26

No Irda ban

■ THIS refers to your report 'Irda tells postal department to fall in line, triggers row' (ET, Apr 19). We would like to clarify that no threat has been received from Irda to ban policies of Postal Life Insurance/Rural Postal Life Insurance. It may be mentioned here that the insurance activities of the department of posts are exempted under Sec 118(C) of the Insurance Act, 1938. The question of Irda threatening to ban postal insurance policies, therefore, does not arise. Your report has created apprehension in the minds of our customers. Regarding the under achievement of targets, we would like to point out that Postal Life Insurance and Rural Postal Life Insurance have registered a consistent growth. In fact, during the year 2009-10, we have achieved a remarkable growth of 85% in Rural Postal Life Insurance and about 15% growth in Postal Life Insurance in terms of number of policies.

S K SINHA
CHIEF GM, DIRECTORATE OF
POSTAL LIFE INSURANCE
NEW DELHI, MAY 20

Letters to the editor may be addressed to
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BLINKERS OFF

SALAM



I know you are not the protesting type and it will be easy for you to take it...

NEURAL NET

Madam M's museum

POWER corrupts and absolute power corrupts absolutely. Someone said this, it does not matter who. All that matters is this widely used phrase was uttered centuries after the renaissance and it has now, existing and proving its truth for more than a century, turned into a axiom apt for Ms M who runs her fief, known to everyone by just two letters U & P, in this country. But perhaps Ms M, in her quest to launch a sort of postmodern renaissance, would prefer: powerlessness uplifts and absolute powerlessness uplifts absolutely. Renaissance flourished without power: all the light it shone on the world, please remember, came without light! Not some metaphysical sort of light but light that is woefully lacking in Ms M's sweat-without-toil land.

Ms M's guru, who came from a land which had a revolution that put more food on our country's plate, taught her a lesson: first keep everyone dry and then see them attain a high. Ms M, so drawn was she to this revolutionary thought that she took to it like the heatwave to our heartland, and started applying it in her pursuit of, well, art. An artless art, a post-modern art. A mix of gravitas and grunge. Ms M knows pretty well that the renaissance flowered without power. Michelangelo's murals, still considered the apogee of art, were made without any light, the comfort of fans and ACs an entirely absent thought. Ms M, possibly familiar with the lives of great renaissance artists, is trying to replicate something, in a post-modern way, in her benighted kingdom. To keep the engine of her ritzy renaissance humming, she keeps whimsically switching off power to her fief. Kept in the dark, and dehydrated because of the scorching heat, her land is supposed to spawn greater and more versatile artists than Michelangelo and da Vinci.

Ms M's stilled statuary, perhaps, scuppered her hopes of having murals painted outside her lavishly spread house or inside her well-appointed bathroom, but she is still chasing her dreams. A Michelangelo in your bathroom and your sweat, generated with hardly any drudgery, would seem like a cold shower. A commode by da Vinci would clear you of all constipated thoughts. Populate your brain with ideas whose gravitas will be more weighty than a two-tonne AC. Michelangelo would have done it gratis, so



smote would he have been with Madam's love for David. All for public good. An array of marmoreal Ms Ms that will, perchance, be called masterpieces after two hundred globally warmed years. People will only shower warmth on these statues and salute the hard toil and artistry that went into making them. Like David, Ms M, too, would be enshrined in the annals of supreme art. The diffidence of David, of course, supplanted with the coldness and aloofness of magisterial Ms M. The lady, advancing her postmodern renaissance push, tried to construct a mall in the vicinity of a monument to love that happens to be in her kingdom (the builder maybe had the prescience to know about a new renaissance!) but was sadly thwarted by trenchant critics of postmodern movements. A marbled, brightly lit and air-conditioned mall, in which reside all the realised and unrealised hope of her parched populace, to view a celebrated work of art from a distance. Henry Miller called America, a postmodern pastiche of voguish ideas and capitalist capers, an air-conditioned disaster, a land that can view great art from afar and hang it in its majestic museums. Ms M, taking a cue, was trying to do just that: an air-conditioned disaster that offered a great vista of a monumental work of art.

Ladies and gentlemen, brace for long and extremely hot nights, for Ms M is still working on her project to produce a new Michelangelo. And, who knows, she may be consulting a da Vinci.

RAKESH BEDI

US banking reform sounds hollow

THE BIG PICTURE

T TRAM MOHAN



- If the US alone were to impose a 'Volcker rule', it would disadvantage American banks. The Fed knows this very well.
- Any country that races ahead of others in setting high capital requirements for banks in its country risks driving banking activity elsewhere
- Politicians lack the appetite to do what it takes, which is to limit size in banking

risky business, not to exit them. In India, we don't expect banks to exit real estate or commodities because they are risky. We impose exposure limits. Exiting risky businesses is a blunt tool for managing risk.

Fortunately, it appears that, whatever the legislation proposed by Congress, the details of the 'Volcker rule' will be left to the Fed. If the US alone were to impose a 'Volcker rule', it would disadvantage American banks. The Fed knows this very well.

The last important piece in the Senate bill is a resolution authority that can seize and wind up a large financial institution that faces failure. In a crisis, this is almost impossible to do especially if creditors have to face losses. The failure of Lehman in the present crisis showed how dire the consequences could be. The Senate bill provides for creditors to be taken care of but would recoup payments made by the government from the industry. In other words, the survivors

would have to pay for the misdeeds of the failures. This sounds ridiculous.

Whatever legislation emerges finally from Congress will have a limited impact on banking in the US as well as on banking globally. For two reasons. One, the details of most of the proposals mentioned above and also the key proposal on higher capital for banks will have to be decided by US regulators. The legislation merely provides broad direction to the regulators.

Secondly, unilateral US action on capital requirements can at best only go so far — maybe, set a requirement slightly higher than the present one. For any imposition of higher capital requirements for banks to be effective, we need global agreement under the auspices of the Bank for International Settlements. Any country that races ahead of others in setting high capital requirements for banks in its country risks driving banking activity elsewhere.

When eventually all regulators agree on higher capital requirements, does that diminish the probability of the next crisis? Not at all. We will still be grappling with one problem, banks that are too big to fail. Neither higher capital nor the outlawing of so-called risky activities nor any resolution authority can address this problem.

And the problem has, if anything, worsened after the present crisis. The survivors have become bigger and dominate banking more than before, the industry has become even more concentrated. The incentives for management at these banks to make reckless gambles remain intact. But politicians lack the appetite to do what it takes, which is to limit size in banking.

They think the problem will somehow go away by limiting the scope of banking activities. As I have pointed out above, scope in banking actually has the potential to diminish risk, so this is actually getting hold of the wrong end of the animal. Policymakers must take the bull by its horns and that means tackling the problem of size. Alas, that may require a bigger crisis than the present one.

Faucet drip, or monsoon?

GENOME pioneer J Craig Venter sports a small salt-and-pepper goatee, appropriate for someone claiming to have synthesised life from off-the-shelf chemicals? In contrast, look at the magnificent beard of God that Michelangelo painted on the ceiling of the Sistine Chapel. One could argue that there is nothing synthetic or cultured about its locks and curls. And it's got 'organic' and 'made in heaven' stamped all over it. (Does that also explain why only the creator Brahma from the Indian Trinity has a flowing beard?)

Venter and his colleagues just built a synthetic genome and showed that it can power itself when placed inside an existing cell. Now was that a small step for mankind? Or was it a giant one? One blogger has called it a "faucet drip that would be a monsoon". She also says that Venter's feat is "not like creating a new garment or even cutting and pasting from previous garments to make a quilt, crazy or otherwise". So it's not a discovery or a paradigm shift. And bioethicists ought not to get into lather about it.

The eastern view is more expansive. Venter's new bacterium is an integral part of the Divine Sensorium, which is indivisible from the Brahman.

Noted philosopher Ken Wilbur calls it Spirit with a capital 'S' to indicate that Spirit is not the highest level among other levels but is the Ground or Reality of all levels, and thus could have no specific qualities or attributes itself, other than being the "isness" (*tzu jan*) or "suchness" or "thatness" (*tathata*) of all possible and actual realms.

In other words, this is the unqualifiable Being of all beings.

The other important distinction that Wilbur makes about Spirit in his summary of the mystical writings of the world's greatest physicists is that it is neither the One nor Many, neither infinite nor finite, neither whole nor part, "for all of those

(epithets) are supposed qualifications of Spirit, and thus could best apply to spirit (with a lower case 's'), not Spirit," he explains in *Quantum Questions*.

"This is exactly the Buddhist doctrine of *sunyata* ('nonqualifiability'), the negation of all negotiations. And in particular notice that Spirit is not One, not wholeness, not Unity — *neti neti* — for all of those are dualistic concepts, possessing meaning only in contrast to their opposites." Only such inherent paradoxes have the power to spark dialogues between science and mysticism. ■ VITHAL C NADKARNI



COSMIC UPLINK