safe eCollege Gateway to the Financial Markets

Volume 31

FINANCIAL ADVISOR PRACTICE JOURNAL

Journal of The Security AcademyAnd Faculty of e-Education

Safe Updates (Keep Informed)

The Securities Academy & Faculty of E-Education

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Editorial Preamble: Blockbuster

1.1 DON'T SHORT THE MARKET

Stocks could touch crazy levels

Even if you are outright bearish, don't short the market. Stocks could touch crazy levels, but they may be in currencies which are worthless. Indeed, a sovereign default and currency turmoil could rattle world markets, in a year or two. The real excitements, according to Jim Rogers, could be cotton, silver and sugar, where a lot of money can be made.

Central banks all over the world have printing huge amounts of money, and the real economy is not strong enough for all this money to be absorbed…so, it's going into stocks and real assets such as commodities. It's a mistake what they are doing. It's giving short-term pleasure, but there's long term pain as we are going to have much higher inflation, much higher interest rates and a worse economy down the road.

The American bond markets already is beginning to go down dramatically as people realise that the American government has to sell huge amount of bonds, and secondly, there is going to be inflation, serious inflation as it was always in the past when you had governments printing huge amounts of money.

Stocks are rising even as fiscal deficit is widening. Somewhere it has to snap. Probably, it's going to snap later this year, next year. We are going to have currency problems, may be even a currency crisis. I don't know with which currency – may be with the pound sterling, may be with US dollar, who knows. It may be with something none of us have at the moment. When you have a currency crisis, stocks will be affected, many things will be affected.

It is not sound, what's happening out there in the world. In 1918, the UK was the richest and the most powerful country in the world. Within one generation it was in shambles, within two-and-a-half generation it defaulted. The UK defaulted in 1970s and had to be bailed out by the IMF. Many of the countries in the developed world are in serious trouble right now. Iceland has already defaulted. I think there could be a currency crisis because of sovereign debt problems later this year, next year or 2011. Developed nations have defaulted before. Remember the Asian crisis. It was a default of one kind or the other. It has happened before and it will happen again.

I am glad that I have no investment in the UK – neither long, nor short. I am convinced that it's in trouble. I am worried about the US. I have sold nearly all of my US dollars. I always had some as I am an American citizen. But I see serious problems developing there. These two of the big developed countries are the ones that I see with the most likely problem. But the problem is that it never works that way. Everybody is sitting here watching the UK and US and it may happen in say Portugal or some place we haven't thought of and it's going to come suddenly to surprise us all.

That naturally brings us to the debate on a new international reserve currency. Several countries have raised the issue once again. The US dollar is terribly flawed right now. Something has to be done to the US dollar and something will be done as something was done about the pound sterling. After World War II, people stopped using the pound sterling and converted to the dollar for many reasons. Something's going to be done about the dollar. We are much closer to be doing something about it or will be forced to do something about it and world will be forced to change currency situation in the foreseeable future.

At one stage we were inundated with gloomy forecasts, which were further reinforced by the IMF and World Bank. And then suddenly stocks surged – something most were not prepared for. So, how risky is the market today? And what kind of market are we witnessing now?

Jim Rogers explained that it's a bear market rally. I was going to say: I don't think S&P 500 will see new highs. But I have to quickly temper that by saying against the dollar because the S&P 500 could triple from here. If they print enough money and the value of the US dollar collapses, then S&P could go to 50,000. Dow Jones can go to 100,000. This is one reason why I am not shorting stocks right now. Because there is a possibility of this sort of a thing, there is a possibility that stocks could go through unheard of levels, but would be in worthless currency.

In 1930s, we had a huge stock market bubble which popped. And then politicians started making many mistakes. They became protectionist. They made solvent banks take over insolvent banks and then both banks failed in the end. They are doing many of the same mistakes now. What's different this time is that we are printing huge amounts of money which they did not print at that time. So we are going to have inflation this time. There is already an underlying fear that this mountain of cash will chase assets and eventually force central banks to mop up the liquidity.

But, how do you think this would play out? I know they all say, don't worry; we will reverse gears and take the excess liquidity out in time. I don't believe them for a minute. No one has ever done it that way. When central bankers started trying to, it has caused so much pain that they quickly reversed or they have got rid of that central banker and put somebody else in. I just don't think they could do it. That's why I am worried about the bond market and I am worried about the inflation. If all central banks do it together, that's going to lead to higher unemployment, riots in the streets, civil unrests.

So, legendry investor Jim Rogers' message to tens of thousands of hotshot fund managers who seeks his advice is to become a farmer. He said: If I am correct, the financial community is not going to be great place to be for the next 30 years. We have many periods in history when the financial people were in charge. Similarly, we have many periods when people who produced real goods were in charge – miners, farmers, etc. The world, in my view, is changing and is shifting away from the financial types to producers of real goods, and this is going to last for several decades as it always has. This may sound strange but it always happen this way. Ten years from now it may be farmers who are driving the Lamborghinis and the stock brokers are going to drive taxis at best.

The world has been consuming more than it produced. Food inventories are at a multi-decade low. And we haven't had any bad weather. But if it does, the prices of food would go through the roof. If there is climate change taking place the best way to participate is through agriculture or through agriculture products. There are many positive things happening. Right now there are shortages of everything in agriculture – seeds, fertilisers, tractors, tractor tyres. We have shortages of farmers because farming has been a horrible business for the past 30 years.

My way of participating on what's going on now is to buy commodities. In my view, commodities are the only place where fundamentals are improving. Farmers can't get loans for fertilisers now, even though inventories of food are the lowest in decades. Nobody can get a loan to open a mine. So, you will have supplies of everything continuing to decline.

Even, if you want to buy crude, you should probably buy **cotton** – Because all farmers in the US are planting corn to turn into energy. So that means they are not going to plant any cotton. The best way to play crude oil is to buy cotton. Right now, there are huge subsidies around the world for farmers to plant corn, maize for instance so that they can be converted into energy. If energy prices go higher, there will be even more of that. If everybody plants his field with soya, corn or palm oil to turn it into oil or energy than no one is going to plant cotton. And you can make a lot more money in cotton than oil. The other way to invest in oil is to buy **sugar** as everybody is converting a lot of sugar into energy.

I own gold but I think silver is better right now. Silver is much cheaper on a historical basis. And gold is near its all-time high. Silver is 75% below its all-time high. So I would suspect that silver and cotton are going to do better than gold and oil.

We hope the new Indian government does something. I have heard wonderful things from Indian politicians for 40 years. And rarely do they produce. It's not the first time that the Congress party has been in power. If they mean it, India's going to be one of the greatest development stories in the next 20 years. But I don't know if they mean it. Why isn't the currency convertible, why isn't foreign capital encouraged, why isn't foreign expertise encouraged, why is it so protectionist, why farmers are only allowed to own five hectare?

India should be the greatest farming nations in the world. You have the soil, the weather; you have everything and yet an Indian farmer can own only five hectare. How is that an Indian farmer can compete with a guy in Ireland who can own a 1,000 hectare or a guy in Brazil who can own 5,000 hectare. Smart people don't become farmers. Because what's the future? Whenever prices start going up, Indian politicians ban futures trading, as if futures' trading makes prices go up. It's the most craziest and absurd thing in the whole world. Prices go up because there is a reason for prices to go up.

An opportunity in crisis:

Legendry investor Jim Rogers warned that the very measures taken by the recession-hit western countries to spur growth could cause a bigger crisis for the world economy. The crux of Roger's argument is that the central banks have printed a huge amount of money which the real economy may not able to absorb. All the money may fuel asset prices again. In the long run, he warns, this liquidity deluge would lead to high inflation and interest rates and a worse economic downturn. That excess liquidity in the global system could create another commodities bubble. In that case, it is argued, the central banks would not be able to act quickly enough for fear of causing a deeper crisis.

Where does that leave the investors? Jim Rogers himself admits that he would not short stocks. The rising tide of liquidity could take them to 'crazy levels'. So in the short term, no matter which scenario you believe, stocks appear to be a good bet. In fact, real assets such as commodities or land have an even greater appeal in likely high inflation situation. Indeed, Rogers makes out a case for agricultural commodities. Many would disagree with the notion of commodities running up sharply in the early stages of recovery when demand is weak. One can argue endlessly, but what is true is that there is a liquidity deluge thanks to monetary loosening. And such a policy did cause possibly the greater run up in asset prices that ended late last year.

1.2 STOCK MARKETS

Lock-in is the new trend for investors

Stay put: In a world where capital is scarce and investors are tentative, policymakers, regulators and even companies are checking flight of capital through riders in investment contracts, at least in India. Lock-in is the name of the game: you can't cash in on your investment before a minimum period of time. Sample this: telecom regulator Telecom and Regulatory Authority of India (TRAI) mooted a three-year lock-in for promoters' equity in new telecom operators after Unitech and Swan offloaded substantial stake in their telecom ventures to foreign companies within nine months of acquiring the licence.

Similarly, real estate companies and even wealth managers are insisting on lock-in periods ranging from six months to three years from home buyers and investment clients to check volatility and speculative activities. Also, the government and the central bank are considering lock-in clauses on foreign fund flow into venture capital firms and bank loan securitisation to improve risk management.

The latest trend has its roots in the collapse of financial biggies in the West, which led to a significant flight of capital from world over to safety on US treasuries, resulting in a global cash crunch and a market crash. At one point, 3-month US Treasuries were trading at negative yields highlighting the level of fear in markets. With leading economists blaming the free market economy for the current global recession, policymakers are taking steps to check free flow of capital across industries and economies.

While the particular reasons for each instance may differ from case to case, the broad underlying consideration remains the same – providing an antidote to the uncertain business conditions. Housing developers, for example, have introduced lock-in periods for buyers in new projects to keep out speculators, who pushed prices to an unsustainable level during the realty boom that was halted in the middle of the last year. Tata Hosing announced a lock-in-period of six to eight months for its low-cost homes in Mumbai. India's biggest realty player DLF too has introduced a lock-in period of one year for re-sale and is selling only one flat to each family in its upcoming residential projects.

Even wealth managers are creating strategic portfolio for their rich clients where they require to invest a minimum sum with a lock-in period. Ultimately, lock-in is a method of shielding a business or an individual against actions taken on impulse. The idea is to get rid of the volatility from the system. ASK Wealth Advisors; for instance, had launched a product for its high networth individual clients where they were required to invest a minimum of Rs 10 crore with a lock-in period of three years. Eventually lock-in is allowing tying down of customers over a foreseeable time horizon. Mutual fund houses, for instance, are launching more close-ended funds in the market. For instance, all four of the ongoing new schemes launched by Tata Mutual Fund are close ended.

Business consultants believe that at a policy level, lock-in requirements act as a counter-cyclic risk weightage in high-risk areas. This ensures there is a certain amount of predictability in an economic activity, which enables better business planning and execution. The central bank, for instance, is also doing its bit to fix the liquidity issue that surfaced in the current crisis through the lock-in method. The RBI recently prescribed a minimum lock-in period for securitizing loans purchased by banks. This means banks would be barred from selling the assets immediately after the creation or acquisition of assets.

There are plans to even bring stricter norms pertaining to inflow of foreign direct investment (FDI) into trusts registered as venture capitalists (VCs). A government proposal aims to introduce a lock-in period and a minimum capitalisation stipulation for such inflows to ensure that VCs serve only legitimate objectives. Financial advisors say, lock-in can be an effective method to ensure working capital (whether through the venture capital or public markets route) is available when the business needs it most. Maintenance of this capital during the growth phase is critical to the survival of the business.

1st week of June '09 – Sensex, Nifty hit 10-month highs

Sensex hits 15,000 intra-days on Wednesday

The BSE Sensex, which had breached the 15,000-mark in intra-day trading on Wednesday, shut shops a flat note after its key stocks cattle under selling pressure. Broader benchmark indices however remained firm. The 30-scrip Sensex opened at 14,902.62 points but ended at 14.870.9 points – 4.01 points, below Tuesday's close. The Sensex touched an intra-day high of 15,046.34 points and a low of 14,733.59.

Daily review	29/05/09	01/06/09	02/06/09	03/06/09	04/06/09	05/06/09
Sensex	14,625.25	215.38	34.28	(4.01)	137.78	94.87
Nifty	4,448.95	80.95	(4.65)	5.45	41.95	14.25

Sensex ends above 15,000 on Thursday

At his prime, Big Bull Harshad Mehta did not have to actually buy stock to send its price shooting; he merely had to enquire about the price of that stock. The newly-elected UPA government seems to be wielding a similar power over the markets. The mere mention of **proposed** economic reforms is enough to send delirious bulls rushing to load up on shares, almost certain that a new bull market is underway.

As the 30-share Sensex rebounded 400 points from the day's low to close above the psychological 15,000-mark on Thursday, a large section of the deep pocket buyers are now worried that the markets is now climbing too fast for comfort. Shares began the day on a subdued note, in line with the bearish mood in Asia, and were down nearly 2% at one point. But the mood perked up as the President made a speech outlining the policies of the UPA government, which broadly aims to boost economic growth while maintaining low inflation and adhering to fiscal prudence.

Market watchers say shares prices are unlikely to fall sharply because forthcoming economic data could point to a further improvement in the micro environment. Already, performance of six core industries in April has been the best in 10 months. The infrastructure index has a weight of 27% in the overall IIP (Index of Industrial Production).

Weekly review	29/05/09	05/06/09	Points	%
Sensex	14,625.25	15,103.55	478.30	3.27%
Nifty	4,448.95	4,586.90	137.95	3.10%

Sensex, Nifty hit 10-month highs

Indian bourses progressed rapidly with key indices – Sensex and Nifty – hitting nearly ten-month highs as investors were heartened by new UPA Government's economic agenda, unveiled by President Pratibha Patil in the week under review. The markets achieved new highs in sustained volatility and the Sensex closed past the 15,000-psychological level for the first time since September 2, 2008.

Accentuated interest of investors in second line stocks pushed up the Smallcap and Midcap indices by a whopping 7.88% and 6.98%, respectively, outperforming the bellwether Sensex. FIIs, the principal market moving factor, remained consistent net buyer in equity. Analysts said the market is strongly bullish and may witness a pre-Budget rally. The full Budget is likely to be presented on July 3 by FM Pranab Mukherjee. Sectorial indices such as the BSE Consumer Durables Index soared by about 10% and the BSE Capital Goods Index by 8.40%. Silver prices snapped four-week of winning string while gold also reacted downwards on the bullion market during the week under review.

Poll vault: Punished stocks emerge new champions

It's a case of 'the most punished stocks' turning into outperformer post election results. Among the BSE 500 companies, as many as 458 companies outperformed the sensex between May 18, 2009 and June 4, 2009. Surprisingly, the outperformers are not those fundamentally strong or defensive companies, which investors were chasing, during the last one year but those which were major underperformers mainly because of dearth of funds. However, with the liquidity condition improving, investor's focus is now shifting towards the companies where the perceived value is high.

Analysts say when market sentiments move from extreme pessimism to cautious optimism, the most punished stocks – which investors in the past have mercilessly offloaded – always gain the most. When the equity market fell during 2000-2002, even Infosys Technologies lost almost half of its market price but the stock was one the outperformer in the following bull-run.

2nd week of June '09 – Market remains bullish this week

Daily review	05/06/09	08/06/09	09/06/09	10/06/09	11/06/09	12/06/09
Sensex	15,103.55	(437.63)	461.08	339.81	(55.34)	(173.53)
Nifty	4,586.90	(157.00)	121.05	104.30	(17.55)	(54.30)

Weekly review	05/06/09	12/06/09	Points	%
Sensex	15,103.55	15,237.94	134.39	0.89%
Nifty	4,586.90	4,583.40	(3.50)	(0.08%)

Block deals add to market confidence

Bolstered by a resurgent Dalal Street, deals in the Indian equity market are moving in. FIIs, brokerage houses, promoters of companies and mutual fund companies have collectively transacted securities worth Rs 1,450 crore through this window in the first 12 days of June on BSE, which is almost four times the amount transacted in May. Around 3,133 lakh shares have been transacted under this window till date this year, which is a 33% increase in the number compared to the said period last year. In monetary terms, the BSE has witnessed a volume of Rs 2,954 crore in the block deal this year. Analysts say the rising volumes are indicative of the returning confidence and liquidity to the Indian capital markets. Block deals are directly proportional to the secondary market conditions. The flurry of block deals is testimony to the fact that institutional buyers are back in business. Usually, big shareholders in companies use this window to sell part of their stake to raise money. Since the deal is carried under a block, liquidity is absorbed without moving stock prices. For a transaction to qualify as a block deal, a minimum quantity of five lakh shares or a minimum sum of Rs 5 crore should be executed via a single transaction.

3rd week of June '09 – Sensex snaps 14-week rally, drops 716 points

Daily review	12/06/09	15/06/09	16/06/09	17/06/09	18/06/09	19/06/09
Sensex	15,237.94	(362.42)	82.39	(435.07)	(257.31)	256.36
Nifty	4,583.40	(99.40)	33.80	(161.65)	(101.75)	62.20

Weekly review	12/06/09	19/06/09	Points	%
Sensex	15,237.94	14,521.89	(716.05)	(4.70%)
Nifty	4,583.40	4,313.60	(269.80)	(5.89%)

Last day's gain in share prices following several measures announced by Sebi failed to maintain a 14-week rally as profit-booking emerged at higher levels in view of capital outflows from foreign funds. World stocks fell on Monday after finance ministers from the Group of Eight leading industrialized countries last Saturday, said they have begun discussing how to unwind the fiscal and monetary policy measures undertaken in response to the financial and economic crisis that spread last year.

4th week of June '09 – Sensex gains 1.67% on global support

Daily review	19/06/09	22/06/09	23/06/09	24/06/09	25/06/09	26/06/09
Sensex	14,521.89	(195.67)	(2.21)	98.72	(77.11)	419.02
Nifty	4,313.60	(78.35)	11.75	45.95	(51.10)	133.65

Weekly review	19/06/09	26/06/09	Points	%
Sensex	14,521.89	14,764.64	242.75	1.67%
Nifty	4,313.60	4,375.50	61.90	1.44%

Indian bourses continue to shine after it broke the longest weekly streak last week and gained 1.67% amid a forecast of below normal monsoon this year. The market had fallen back by 716.05 points or 4.70%, after rising by a whopping **6,912 points**, **or 83%,** during the long 14-weekly gaining streak. Analysts attributed this dramatic reversal of positions to derivatives July series which expired on June 25. They also visualised a range-bound and volatile trade during next week ahead of the full budget that is expected to be a major trigger for the market. Infrastructure, capital goods and bank stocks attracted brisk activity during the week with high rollover of positions was seen in these sectors on strong optimism that they will get major thrust in the forthcoming budget. The market is likely to set direction from the economic survey to be presented on July 2 followed by the Railway Budget on July 3.

End of the June '09 – Sensex lost 271 points

Daily review	26/06/09	29/06/09	30/06/09
Sensex	14,764.64	21.10	(291.90)
Nifty	4,375.50	15.45	(99.85)

Weekly review	26/06/09	30/06/09	Points	%
Sensex	14,764.64	14,493.84	(270.80)	(1.83%)
Nifty	4,375.50	4291.10	(84.40)	(1.93%)

6-Monthly review

Month	Dec '07	June '08	Dec. '08	June '09
Date	28/12/07	30.06.08	31/12//08	30/06/09
Sensex	20,206.95	13,461.60	9,647.31	14,493.84
Points	Base	(6,745.35)	(3,914.29)	4,846.53
%	Base	(33.38%)	(28.33%)	50.24%

2.1 INDIAN ECONOMY

No pangs: At 6.7%, growth up to the mark

Fuelling hopes that the worst is over, the Indian economy grew at higher than expected 5.8% in the quarter ended March ’09 on the strong growth in services and agriculture sectors. Despite the deepest economic crisis facing the global economy in sex decades, the country registered an impressive 6.7% growth in the fiscal year 2008-09, indicating that it may expand faster in the current fiscal.

The government expects the economy to grow at a much faster pace in the coming months, as the earlier stimulus packages announced by it are expected to show results. Measures such as the Rs 5,000 crore package for building 10 lakh affordable homes and government decision to buy about 15,000 buses by the end of the June ’09 are expected to have their desired effect in the coming months. Though shrinking export demand remains a concern, it is likely to be addressed in the forthcoming Budget.

Forecasters, forecasting and forecasts

The season for GDP upgrades for India has kicked off, with more favourable revisions. In fact, India has just embarked on a new economic cycle. There are several reasons for optimism: the better than-expected GDP growth for the January-March quarter and the upward revision to growth in the October-December quarter suggest that the hit to the economy has been less pronounced than what was generally anticipated. Further, the combination of the game-changing election verdict, improving high-frequency economic data, pickup in foreign capital inflows, and the revival in equity markets has worked like an acceptable steroid to boosting investor and consumer confidence.

Tracking GDP growth forecasts by different entities, the CSO (which announces GDP data) and the Prime Minister’s EAC deserve prizes. The EAC announced its downward revised forecast of 7.1% for 2008-09 in January. Almost everyone dismissed the forecast as being unrealistic. In February, the CSO advance GDP growth estimate of 7.1% for 2008-09 was also labeled as being from la-la land.

Now, the first-cut estimate by the CSO has pegged GDP growth in 2008-09 at 6.7%. We guess revised data will get the number closer to 7.0%. If the EAC and the CSO deserve accolades for not losing their heads at a time of great uncertainty, some private sector forecasters, the IMF and ICRIER, a New Delhi-based think tank, forecasting doomsday scenario for India that has failed to materialise. So what about the super-bearish forecasts of the IMF and ICRIER?

In April, the IMF forecast (calendar year basis) India’s GDP growth at 4.5% and 5.6% for 2009 and 2010, respectively. It is likely to be wrong on both.

ICRIER’s GDP growth forecast of 5.8% for 2008-09 and of 3.9% for first-half 2009-10 was announced in December 2008. It was sensational to say the least. And that such a bearish forecast came from a premier think tank that presumably has good access to policymaking circles made it even more eye-popping. Curiously, it is also perhaps the only entity that initially announced growth forecast only for the first half of 2009-10. In March, ICRIER revised its GDP growth forecast for 2008-09 to 6.3% basing it on the shock intensity being moderated by policy response. The actual GDP growth outcome for 2008-09 was slightly better. ICRIER’s forecast for 2009-10 (announced in March) is 5.5%. In contrast, the EAC had much earlier (in January) stuck its neck out and forecast a range of 7.0-7.5% for 2009-10.

Let there be no doubt that there was significant potential for things to have gotten nastier for the economy. But the super bears possibly underestimated the impact of the aggressive fiscal and monetary policy response, and the resilience of rural spending. Perhaps they also ignored the signals from emerging green shoots, though all have legitimately been surprised by the earlier turnaround in capital inflows.

India to grow fastest in 2010: World Bank

The World Bank has projected an 8% GDP growth for India in 2010, which will make it the fastest-growing economy trailed by China with 7.7% growth. The report pointed out that prospect for the global economy remain "unusually uncertain" despite recent signs of improvement in parts of the world, and expects the world economy to contract by 2.9% in the current year. Despite the gloomy picture for this year, the bank said growth in developing countries, led by India and China, could reach 4.4% in 2010 and 5.7% in 2011. Because global growth will only return to its full potential by 2011, the gap between the actual and potential output, unemployment, and disinflationary pressures continue to build.

India's growth engine gathers greater steam

Positive growth numbers in a few key sectors coupled with fresh FII and FDI inflows may place the India story on a faster track. Both the government and industry, which are now betting on non-export driven sectors thanks to the renewed domestic demand, are hopeful that India would be able to tide over the current slowdown faster than anticipated earlier.

Whereas industrial output surged 1.4% in April, 2009, what has really made the government confident is unexpectedly good numbers in a few sectors of the economy. The growth in food and beverages segment was as high as 21.7% in April as compared to the same month last year. Similarly, FMCG registered 19% rise in April and for electricity, the growth was 7.3%. The growth in the coal sector was 13.2%.

Explaining the numbers, department of industrial policy and promotion (DIPP) secretary Ajay Shankar says that the government is hopeful of a faster economic recovery because of very good numbers of some sectors. These numbers coupled with $8.5 billion FDI during the first four months of the calendar year brought fresh hope to the economy. In fact, India attracted FII of $5.3 billion during April and May. The positive FII numbers in these months were recorded after the net FII outflow for 8-consecutive months.

PM's push for financial reforms

In the very first Cabinet meeting of the new government, Prime Minister Manmohan Singh laid particular emphasis on the need to speed up financial sector reforms. This may have surprised some Cabinet members who had assumed that financial sector reforms had lost their sense of urgency after the global financial meltdown. If anything, the intellectual case for going somewhat slow on financial sector reforms seemed to have gained some currency after the collapse of big banks across the US and Europe last year.

However, delaying the reform of the financial sector in India would also mean postponing building a truly modern, better regulated financial system that caters to all the needs of the second largest growing economy in the world. Should we stop building new roads and expressways simply because we fear there might be more accidents along the way? This is the real question that needs to be answered in the context of the need to build a world class domestic financial system. Indeed, it is this sense that Dr Manmohan Singh spoke about the need to have much more robust financial sector reforms. The history of modern capitalism is also about the history of progressive refinement of the global financial system. The West dominated this process through the past few centuries. This dominance will shift to the east as higher volumes of economic activity incrementally originate in economies like India and China. The need for financial sector reforms in India must be seen in this larger perspective.

2.2 INDIANS

A New Deal for the Poor

Franklin D Roosevelt pushed 15 major piece of legislation through Congress in his initial 100 days as part of the New Deal that pushed the US economy out of depression during 1930s and created much of the modern US social safety net. Since then, may new governments in the democratic world often show their commitment to the people by getting into high gear in the first 100 days, be it the Obama administration in the United States or the Manmohan Singh government in India.

With shackles of the Left gone, there is high expectation of reforms from the Manmohan Singh government that can get the economy back on the 8-10% growth trajectory and also give a New Deal to the poor. The implementation of the promised National Food Security Act (NFSA) is high on the agenda, and so is putting agriculture on a 4% growth path, besides several big ticket items like divestment in PSUs, reviving exports, and so on. The big question is not whether the government can do it, but how best it can manage within the limited resources. Let us concentrate on two key issues – NFSA and agriculture that may fall within the purview of the ministry of agriculture and consumer affairs.

The President of India hinted in her speech to the joint session of Parliament on June 4, 2009, that the government will bring in NFSA that will entitle by law all below-poverty-line (BPL) families 25 kg of grain (wheat and rice) per month at Rs 3/kg. Many fear that this permanent commitment may cost the government more than Rs 50,000 crore, creating a big hole in the already precarious government finances. But we strongly feel if the government plays smart, it can easily fulfil this commitment with much less resources, and can take major step towards a hunger free India, giving it a huge political mileage. How? Here is a back of the envelop calculation and common sense approach to do it in smart way.

With the economic cost of grain to be around Rs 15/kg, the subsidy will be Rs 12/kg. The commitment of 25 kg per month to BPL families translates to Rs 3,600 food subsidy to BPL families per year. The total bill for such a scheme will depend upon the number of BPL families in the country, and that's where there is a lot of confusion and bungling. Going by the Planning Commission's approach as on March 2009, there are not more than 60 million BPL families. This means the total subsidy bill will come to Rs 21,600 crore. But the BPL families are already getting grains at less than Rs 6/kg. If this is taken into account, the extra cost is only Rs 4,500 crore.

The problem, however, is that the current number of BPL cards issued in the country under the PDS system is almost 107 million. In fact, in some states, like Andhra, almost the entire population is shown as BPL, whereas in other states where real poverty is much more, the majority does not have BPL cards. This is ridiculous and speaks of an utter failure of governance, leading to 30% to 40% leakage from the current PDS system, which needs to be corrected once for all, in a transparent, fool proof, and ingenious manner, if we really want to help the poor. How can we do it?

We may have to think out of the box and combine new technology with *desi* (local) ways of identifying the real poor in the country. Can we say that all these who have motorized vehicles, or electricity bills above a minimum cut off, or a regular job in the organised sector, or a cell phone with some minimum bill, are not BPL? All such people are registered at one place or another and can be scanned through computers and combine this with a sort of social audit (*desi* ways). There could be many innovative approaches that can be used along with modern ICT tools to identify the poor.

The success of NFSA critically hinges on this identification process, and we need to put a lot of effort and creativity to do it right. The returns will be enormous, else it can prove to be another mismanaged 'flagship' programme with high cost; and hunger will still continue to haunt several million people in this country.

But the long-term food security lies not just in food coupons, but in raising production of staples and augmenting farmers' incomes through other agri-commodities, especially through high-value agriculture such as horticulture, livestock and fishery. This will dovetail with the 4% targeted rate of growth in agriculture. How does one achieve this?

Foodgrain production needs a switch in strategy; from the heavy reliance on north-west to a move to eastern India (Uttar Pradesh, Bihar, West Bengal, Assam, Orissa and Chhattisgarh). This is where water is, and this is where the future grain basket of India lies.

But it needs large investment in controlling flood, building infrastructure of roads and markets, having electricity for tubewells, and so on. The technologies are there, which can raise yields significantly by 50% to 100% in three to five years, but it needs the right policy environment and investment in basic infrastructure. The bill could be Rs 10,000 crore a year for the next three to five years, to ensure food security of the nation for the next 20 years. The target of achieving 4% rate of growth in agriculture is not an impossible task. During 2000-01 to 2007-08, while the all-India agri GDP growth rate was 2.9%, there are states like Gujarat where agri-growth rate was 9.6% p.a. It is time for many other states to show a similar stellar performance, and the Centre's job is to encourage, enable, and reward such states!

Nilekani appointed as chairman of UIAI

In a move aimed at infusing professional expertise into the government's ambitious unique identification programme, Infosys co-chairman Nandan Nilekani appointed as chairman of the Unique Identification Authority of India (UIAI). Mr Nilekani, who resigned from Infosys soon after his appointment to the key government post, will have the status of a Cabinet minister in the Manmohan Singh government. The Board of Directors at Infosys has already accepted Mr Nilekani's resignation. The resignation would be effective from July 9, 2009. Infosys chairman NR Narayan Murthy said, "The government has been working on improving arrangements to ensure that development deliverables reach the intended beneficiaries." As co-founder of Infosys, Mr Nilekani served as director since its inception in 1981. Between March 2002 and June 2007, he served as the company CEO and MD. He was later re-designed as co-chairman of the board. "We are glad that an extraordinary individual like Nilekani has got an opportunity to add value to India through this position. As a company that has always put the interest of society ahead of itself, Infosys will accept his absence with a sense of duty to a larger cause."

The UIAI established under the aegis of Planning Commission in January 2009, will be responsible for laying down the plans and policies for implementing the UID scheme across the country. It will work in coordination with the Registrar General of the India, which is finalising the National Population Register. The government proposes to issue a UID number to all citizens by 2011. The authority shall own and operate the UID number database and also look after its updation and maintenance on an ongoing basis. Besides addressing security concern, the UID project will overhaul and direct the delivery mechanism for public goods and services to intended beneficiaries. In the beginning, the UID number will be assigned based on the National Population Register or electoral rolls. Photographs and biometric data will be added to make the identification foolproof. Easy registration and information change procedure are also being envisaged for the benefit of the people. A sum of Rs 100 crore was earmarked for the UID project in the interim budget presented by Mr Pranab Mukherjee in February this year. Dwelling of the UID scheme in his budget speech Mr Mukherjee had said that "the project envisages assigning a UID number to each resident in the country… It aims at eliminating the need for multiple identification mechanism prevalent across various government departments".

2.3 INDIA INC

India Inc opts for QIPs to raise Rs 40,000 cr in 2009

With the market for new share issue still comatose, Qualified Institutional Placement or QIPs, have replaced IPOs as the chosen method in corporate India for raising money. A steady stream of companies have used the QIP route, under which securities are placed with institutions much like private placements, to raise thousands of crores in recent time. And the flood is only set to increase with every passing day.

According to estimates by Thomson Reuters, a leading provider of business information, about 30 more QIP with estimated value of Rs 40,000 crore could hit the Indian markets this year. The number of issues and the amounts raised could turn out to be a record for the Indian capital markets even when compared with the buoyancy of 2007, when QIPs accounted for Rs 25,000 crore. India Inc has already raised almost Rs 5,000 crore from three QIPs so far in 2009. Companies doing the fund raising included Unitech, Indiabulls Real Estate and power trading solutions company PTC India. The money raised via QIPs so far this year has crossed the volumes achieved for the whole of last year. The biggest QIPs expected to take place are likely to be of Essar Oil (Rs 10,000 crore) and Cairn India (Rs 5,000 crore).

Experts say QIPs were mostly being undertaken by companies which were not in a position to raise money via more traditional avenues. Especially companies in real estate and infrastructure sector are looking at QIPs as a means to fund ongoing projects. Besides, many companies those had taken debt at high interest rates and were looking for a means to pay these down. Experts also point out that for many companies strapped for growth capital, the process of raising money through a QIP appears attractive, as it is much quicker and does not require as many approvals from Sebi as an IPO does. The cost of raising funds through a QIP is also less compared to an IPO.

While QIPs definitely seem to have emerged as a window of opportunity for many cash-strapped companies, some analysts feel the amount that could be raised during 2009 may be more in the range of Rs 14,000 to Rs 25,000 crore. The reason: in some cases, the QIP amounts announced bear little link to the size of the company, and are greater than their market capitalisation itself. While companies may be making such announcements to send strong signals to investors, the decision may not necessarily be practical. Also, they are under no obligation to execute the QIP.

Also, QIP bandwagon may soon run out of stream, due to pricing pressures, with fund managers asking for steep discounts to the prevailing market price, much to the dismay of promoters. With everyone having jumped onto the bandwagon, the market is getting crowded and investor fatigue has set in. Investors may take a long hard look at the reasons driving companies to raise funds. Valuations look stretched in most cases. While deals are happening and there is appetite, it is now a question of how much premium you are willing to pay for a company. We are in the midst of a liquidity wave. And investors are picking the stories they want to play. The perceived ‘investor fatigue’ towards QIPs is probably because of concentration of such issuance in few sectors.

Also Sebi is unlikely to alter the pricing formula for QIPs in the near future. Recently, merchant bankers had made a presentation to the regulator, requesting that companies be given more flexibility while pricing QIPs. [QIP is a process, by which a company sells its shares to qualified institutional bidders (QIBs) on a discretionary basis at a price based on Sebi guidelines.] In August last year, Sebi had changed the pricing formula, allowing it to be based on the two-week average share price, so that companies could price the issue as close to the market price as possible. Earlier, the pricing was based on the higher of the six month or two-week average share price. While making presentations to institutional investors recently, merchant bankers got the feedback that the two-week average price in case of most companies worked out to be higher than the current market price. And the institutional investors) were reluctant to take a mark-to-market loss on their books right from the start.

Think about doing "more with less"

Across the world, countries and government have responded in different ways to the prevailing economic crisis. Public intervention has ranged from the provision of short and long-term liquidity, distressed asset funds, guarantees of toxic assets, full scale bank capital injection, nationalisations and brokered rescues.

Closer home, the common question that all Indian companies and businesses must be prepared to respond to is the continuing uncertainty that surrounds the unfolding crisis.

In thinking about this response, it is important to differentiate between the nature of the crisis in India and that in developed markets. Whilst the crisis originated and spread from the financial sector to the real sector in developed economies, in emerging markets like India, the transmission of problems has and will continue to be from the real and manufacturing sector to the financial sector.

Why is this the case? Over the last few years, Indian companies and financial institutions alike financed a very significant component of their capital needs from external funding sources, and from global markets that were flooded with cheap liquidity. For example, in 2007-2008, capital inflows into India amounted to just under 10% of GDP. However, as the consequence of this, Indian companies and financial institutions have repayment and maturity obligations to the tune of over $30 billion in the remainder of 2009 and in 2010. This does not take into account individual obligations or indebtedness, nor does it take into account rupee denominated borrowings.

Obligations of this size and nature, which typically comprise loans, bonds and convertible bonds, are rarely repaid merely from internal accruals and cash flows. Most often, these are refinanced or repaid via fresh borrowings. Given that most international financial institutions are deleveraging significantly and these institutions are expected to remain under pressure in the foreseeable future, this has significant implications for Indian borrowers and the Indian banking system alike and should be taken into consideration as we plan for both today and tomorrow.

In thinking about incorporating a different mindset and approach, one is inevitably drawn to think about the period of irrational exuberance that all of us in some way or the other participated in. However, at the same time, Indian companies and businesses will inevitably start thinking about doing "more with less", prioritising and rationalising limited resources, and even making dispassionate decisions about extricating themselves from investment or business decisions that appeared exciting and sensible in an era of limitless liquidity and capital but may not necessarily make sense in the current reality. To the last point, companies should begun to divest stakes in non-core or marginal businesses, restructure under-performing assets and in certain cases monetise businesses that are even doing well.

At a more micro level, Indian CFOs should look to diversify their resources of capital. They should tap every conceivable avenue for raising resources and start thinking very seriously about amortisations or principal repayments that are likely to become due over the next twelve to fifteen months with a view to building a buffer well in advance of these repayments. In the case of obligations that are governed by financial covenants, future projections should be stress-tested under worst-case scenarios so that a proactive plan to deal with potential violations in covenants can be put into place. And finally, to the extent it is possible; being long cash is something that most companies should aspire to achieve.

In the meantime, the challenge for all of us will be continue to survive this stint in rehab so that we emerge fitter and stronger for the exciting times that must come for India in the years to follow.

2.4 INTERNATIONAL

US credit card reform bill

US President Barak Obama signed into law sweeping reforms that restrict credit card interest rates and fees, making a victory for Democrats trying to help recession-weary consumers.

US President Barak Obama said at a signing ceremony at the White House, "With this bill we are putting in place some *common sense reforms* designed to protect consumers. We're not going to be giving people a free pass and we expect consumers to live within their means and pay what they owe. But we also expect financial institutions to act with the same sense of responsibility that the American people aspire to their own lives".

Analysts said that the enactment marks the crest of a backlash against the card industry after years of rate and fee hikes and aggressive marketing programs that have angered consumers. The reforms won wide backing among lawmakers, who said constituents were tired of hidden charges from card issuers – especially from those US banks that received billions of dollars in taxpayer bailouts.

The law largely codifies a set of rules issued by the Federal Reserve last year and puts them into effect in February 2010, five months sooner than Fed had planned. The law represents the first major financial regulation reform completed by Obama as he tackles a rewrite of the rules of banking and the markets to better protect consumers and investors, and prevent another credit crisis.

Senate Banking Committee Chairman Christopher Dodd who shepherded the bill through Senate said' "Today is the day we finally make credit card companies accountable to their consumers and responsible for their actions". Cardholders will now get a 45-day notice before their interest rate is changed. The industry could potentially lose about $15 billion in penalty fees each year, according to White House estimates. The new will also help consumers carrying card balances as long as they don't fall behind on payments by more than 60 days. After 60 days, their rates may increase.

The law is expected to hurt profits of major card issuers such as Citigroup Inc, Bank of America Corp, JP Morgan Chase & Co and Capital One Financial Corp. Banks say the bill is a setback for banks seeking to retain sorely-needed revenues. The changes may cut the flow of credit to consumers because it will make it more difficult for issuers to set rates based on the risk their customers pose.

The banks were also hit with a one-time $5.6 billion fee by the Federal Insurance Corp to replenish its dwindling deposit insurance fund. The FDIC could impose additional fees later if needed. Banks say the reforms come at a cost. Banks have repeatedly warned higher interest rates are likely to result because it will be more difficult to set rates based on the risk that customers pose. The higher rates mean less credit available for consumers. The industry is already experiencing heavy losses from the 90 million households that carry cards. The losses are expected to worsen as the year goes on.

The American Bankers Association, which represents the biggest credit card issuers, said the law will transform the credit card industry. ABA President Ed Yingling told Reuters, "It will be a very different product, a lot simpler product which is what people want. It does change the economics. It's now a longer-term loan; it's not a short-term loan any more. The law sharply restricts credit card issuers' ability to raise interest rates on existing balances, to charge certain fees and to slap cardholders with penalties".

Americans owed more than $945 billion in credit cards debt in March '09. The amount has fallen during the current recession but credit card indebtedness is still about 25% higher than a decade ago.

Suspicion & discord must end: Obama

Extending a hand of friendship to the Muslim world, US President Barak Obama called for a "new beginning between the United States and Muslim around the world" saying together; they could confront violent extremism across the globe and advance the timeless search for peace in the West Asia. "This cycle of suspicion and discord must end," Mr Obama said.

In a speech that was littered with references to the Quran, Mr Obama, who has been trying hard to repair ties with the Muslim world which has been alienated by US policy, rolled out his plan for engaging with the Muslim world. The President also used his own Muslim roots to push across the message that the US was not against Islam or the Muslim world. Mr Obama started his highly anticipated Cairo speech by going back to history and tracing tensions that were rooted in history. "The relationship between Islam and the West includes centuries of co-existence and cooperation, but also conflict and religious wars." After going into history, Mr Obama also touched on the main sources of current tension including the situation in West Asia, Afghanistan and nuclear standoff with Iran.

On West Asia, the US president said that he understood both the Israeli and Palestinian position. Expressing sympathy for the Palestinian cause, Mr Obama said he supported an independent Palestinian state that coexisted peacefully with Israel. "So let there be no doubt; the situation for the Palestinian people is intolerable, America will not turn its backs on the legitimate Palestinian aspirations for dignity, opportunity, and a state of their own." He urged Hamas to give up violence and recognise Israel's right to exist. At the same time he said it is "deeply wrong" to threaten Israel with destruction.

Saying he would not see the conflict from just one side, he said that Israelis must acknowledge that just as Israel's right to exist cannot be denied, neither can Palestine's and that Israel must live up to its obligation to ensure that Palestinians can develop their society. "The United States does not accept the legitimacy of continued Israeli settlements. This construction violates previous agreements and undermines efforts to achieve peace. It is time for these settlements to stop."

On Afghanistan he said the US had gone into Afghanistan out of necessity after the 9/11 attacks. In which the al-Qaeda killed 3,000 people. He further said that the US did not want to keep troops in Afghanistan. "We would gladly bring every single one of our troops home if we could be confident that there were not violent extremists in Afghanistan and Pakistan determined to kill as many Americans as they possibly can. But that is not yet the case," he said.

Finally on Iran, Mr Obama said that the US has made it clear to the Iranian leadership that it is prepared to move forward. He said he understood the protest that some countries have weapons that others do not. "No single nation should pick and choose which nations hold nuclear weapons. That is why I strongly reaffirmed America's commitment to seek a world in which no nations hold nuclear weapons." He said that any country including Iran had the right to access peaceful nuclear power if it complies with its responsibilities under the nuclear Non-Proliferation Treaty.

For all expectations from the US President Barack Obama's 'most anticipated policy speech, at Cairo University, touted as a historic address to a 'billion people', no body really seriously anticipated the announcement of a tangible, immediate shift in policy.

Obama's speech did indicate a possible new impetus and a departure from status quo. His speech does seem to mark a decisive end to the confrontation and brazen ways of the US in the recent past.

2.5 WARNING SIGNALS

House panel for 'no entry' to corporates in retail

Presenting a picture of gloom, the parliamentary standing committee on commerce has recommended a blanket ban on domestic corporate and foreign retailers from entering retail trade in grocery, fruit & vegetables. It has also suggested restrictions to bar organised retail firms from setting up malls and selling other consumer products. It has suggested putting in place a regulation, National Shopping Mall Regulation Act, to ensure that cartelisation does not take place, and regulate the fiscal and social aspects of the retail sector.

The 42-member panel, headed by BJP leader Murli Manohar Joshi, warned that allowing organised players, domestic and foreign, to enter retail trade would result in the destruction of the economic foundation of the small retail supply chain. "Given that the small retailers are mostly illiterate or semiliterate, they will not be absorbed by corporate retail and result in large scale unemployment. Such a situation will have immense social underpinning", the panel said.

According to government accounts, the total retail business is of the order of Rs 12,00,000 crore, which is roughly one-third of the country's GDP. Of this, 95% is accounted for by the unorganised sector. Retail is the largest manpower employer in the country after agriculture. Unorganised retail accounts for 8% of total employment – more than 40 million persons. The panel is of the view that the projections by corporate retail of creating 2 million jobs is highly exaggerated, and this does not take into account the large numbers who are likely to be unemployed.

In view of the "adverse effects of corporate retail", the panel says there is "a compelling need to prepare a legal and regulatory framework and enforcement mechanism for the same that would ensure that the large retailers are not able to displace the small retailers by unfair means."

Given the country's ground realities, the panel suggested that the existing model of retailing with emphasis on unorganised is the "most appropriate in terms of economic viability". It has suggested that the government should ensure some "built-in policy" to relocate or re-employ persons who have been dislocated by malls in the vicinity of their businesses.

In its report, "Foreign and Domestic Investment in Retail Sector", the panel suggested that the government should "stop issuing further licences for 'cash-and-carry', either to transnational retailers or to a combination of transnational retailers and the Indian partner, as it is a camouflage for doing retail trade through the back door."

At present, 100% FDI is permitted under the automatic route in wholesale cash-and-carry trading. The panel found that the provision of FDI retail in single brand is not strictly adhered to. "Shops in malls are selling other branded items along with the brand for which they got permission. Corporate retailers practice product bundling, whereby products of single or different brands are sold as combinations and bargains in malls."

At present, while no FDI is permitted in retail trading, the government allows, with its prior approval, FDI up to 51% for single brand product retailing. The committee is of the view that single brand retail will "result in unemployment due to slide-down of indigenous retail traders." It will also, the panel argues, result in the sidelining of consumer welfare, as retail giants will, to begin with, corner customers by adopting predatory pricing. However, once the competition from local retailers is wiped out, the panel argues, there will be in a monopolistic situation and dictate retail prices.

Obama's 'post-material' economy

President Obama has made no secret of his vision for America's 21st century economy that will lead the world in '**green' technologies** to stop global warming; advancing **medical breakthroughs** will improve well-being, control health spending and help expand insurance coverage. These investments in energy and healthcare will revive the economy and create millions of well-paying jobs for middle-class Americans. It's a dazzling rhetorical vista that excites the young and fits the country's present mood, which blames 'capital greed' for the economic crisis. Obama promises communal goals and a more widely shared prosperity. However, the trouble is that it may not work as well in practice as it does in Obama's speeches. Still, they press ahead to curb global warming and achieve near-universal health insurance.

However, we should not be stampeded into far-reaching changes that have little with today's crisis. What Obama proposes is a 'post-material economy'. He would deemphasize the production of ever-more private goods and services, harnessing the economy to achieve broad social goals. In the process, he sets aside the standard logic of economic progress. Since the dawn of the Industrial Age, this has been simple: **produce more with less** ('Productivity' in economic jargon). Mass markets developed for clothes, cars, computers and much more because declining costs expanded production. Living standards rose. By contrast, the logic of the 'post-material economy' is just the opposite: **spend more and get less.**

Consider global warming; the centerpiece of Obama's agenda is a 'cap-and-trade' program. This would be, in effect, a tax on fossil fuels (oil, coal, natural gas). The idea is to raise their prices so that households and businesses use less or swifts to costlier 'alternative' energy sources such as solar. In general, we would spend more on energy and get less of it. The story for healthcare is similar, though the cause is different. Till now, we spend more and more for it (now 21% of personal consumption) and get less and less gain in improved health. This is largely the result of costly new technologies and the unintended consequences of open-ended insurance reimbursement that encourages unneeded tests, procedures and visits to doctors. So, expanding health insurance might aggravate the problem.

Together, healthcare and energy constitute about a quarter of the US economy. If their costs increase, they will crow out other spending. The president's policies might, as he says, create high-paying 'green' or medical jobs. But if so, they will destroy old jobs elsewhere. Thinks about it; if you spend more for gasoline or electricity or for health insurance premiums then you spend less on other things. The prospect is that energy and health costs may rise without creating much gain in material benefit. That's not economic progress. Given today's huge and unsustainable budget deficits, some other tax would have to be raised or some other program cut.

What defines the 'post-material economy' is a growing willingness to sacrifice money income for psychic income – 'feeling good." Some people may gladly pay higher energy prices if they think they're "saving the planet" from global warming and they're improving the health of the poor. Unfortunately, these psychic benefits may be based on fantasies. What if US cuts greenhouse gases are offset by Chinese increases? What if more health insurance produces only modest gain in people's health?

Obama and his allies have glossed over these questions. They've left the impression that somehow magical technological breakthroughs will produce clean energy that is also cheap. Perhaps that will happen, is hasn't yet. They've talked so-often about the need to control wasteful health spending that they've implied they've actually found a way of doing so. Perhaps they will, but they haven't yet. We cannot build a productive economy on the foundations of healthcare and 'green' energy. These programs would create burdens for many, benefits for some. Indeed, their weakness may feed to each other.

3.1 MUTUAL FUNDS

Variable cost structure for the MF investment

Innovations from Sebi: In a clutch of decisions Sebi has taken away mutual funds' right to levy an entry load, rationalised the disclosure norms for rights issues, lowered select service and registration fees and introduced the concept of 'anchor investor' in public issues. These reform measures are mostly unexceptionable. Direct investors in mutual funds had already been spared the entry load. Sebi's decision to do away with entry load altogether, leaving investors to negotiate the intermediation fee directly with the distributors, will help lower transaction costs for even those investors who continue to invest the old way, through agents and distributors.

At present mutual funds levy load as high as 3% of investment to cover transaction/brokerage costs without the investor being aware since it was included in the price charged. At a larger level, this nascent move could encourage a fee-based responsible intermediation, a model that could later be extended to insurance as well where hidden levies are very steep.

So the Sebi kicked off a variable cost structure in the MF industry, whereby there won't be any entry load while investing in mutual funds. Investors, however, will have to pay a fee to distributors, based on the service they get. The impact of the regulation will be positive on investor. Now, investors don't need to pay any entry load on the investments made in mutual funds, irrespective of the channel – AMC or distributor – they choose. In short, under variable cost regime, the whole fund would be invested. But the investors will have to pay an extra amount to distributors. So far, investors pay, a commission, irrespective of whether the advice of the advisor or distributor is beneficial. However, after the new Sebi ruling, the price for the advisor can be negotiated. Hence, investors will have the freedom to pay, depending on the perceived value of the advice given by the distributor.

Also, this will bring transparency into the system and the investor would be informed. Till now the investor did not know whether the motivation of advising a particular product was the features of the product or the remuneration or commission earned by the adviser. Now, all the commission that the adviser receives would have to be discussed with investors, which will bring in a comfort factor.

Investors are now more likely to get right and unbiased advice mainly because of two reasons. First, advisers will have to disclose the amount and second, advisers will always run the risk of losing a client because if the advice goes wrong, investors will not consult them again or decline to pay higher commissions next time. So, there will be substantial change in portfolio management services. Advisors used to churn around the portfolio unnecessarily to earn extra upfront revenue. Now, neither the investor nor the advisor will benefit in case of early redemption and this would provide protection from unwanted churning and would also install discipline among the investors for a longer horizon.

As mentioned above, investors will now be able to decide the commission to be given to the advisors. Before investors decide the commission, let advisers pass the litmus test. Since investments is not a one-time affair, the first thing to see is whether advisers are capable enough to give quality services that investors expect, more importantly after sales services, as there are many small things that need to be taken care of, for which the investors may not have the time to run around.

Also, make sure that the advice that has been given to an investor is backed by proper research. Such financial adviser should not only advise you on what to buy and what to sell but also educate you on why you should do so. The adviser must adopt the complete financial planning approach rather than just selling products. The financial adviser must have a good reputation in the industry. They must be well qualified, experienced and should be known for excellent after sales service.

3.2 MARKET TIMING

Refine your judgement while investing

Keynes, the most talked-about economist in these days of bankruptcies and bail-outs, once said, "Markets can remain irrational longer than you can remain solvent." While this theory is applicable to both bears and bulls, the underlying message is undoubtedly clear that rational investors can succeed if they can keep irrationalities out. The broader investment decision of whether to invest in equities as an asset class at a given point of time should depend on the prevailing stock market activity.

While market experts and analysts agree with the learned view that a retail investor should not try to time the entry and exit in a *particular stock*, however, some market experts argue that every investor can time the market to entry/exit *equity markets*.

They argue that stock markets historically have peaked at a time when interest rates also peaked or tended to peak due to higher demand for market related credit fuelled by over confidence.

For instance, an ordinary investor sells all his equity investment whenever the interest rates move up and shifts to traditional FD. This investor started moving his fixed income investments into equities in the early days of this decade when the interest rates were at its lowest. The same investor again shifted from equities to FD in mid 2008, although he missed the peak of the markets in January 2008. Today this conservative disciplined investor has had the last laugh again while conceding that he has no great knowledge of economics. What moved him are sheer common sense and a strict control on emotions.

Analysts have often noticed this correlation between interest rates and market peaks/troughs. They have no hesitation in siding with this investor who uses less of market information and more of common sense to time the market when one is bombarded with an unprecedented supply of market "information." If the interest income is relatively high compared to the low risk associated with the product then there exists an opportunity to shift from equity depending on one's risk appetite.

In contrast, there is an example of another highly-educated investor who was brilliant enough to spot the particular multi-bagger stock when the price was Rs 150 around 10 years ago. When the price went up to Rs 1,500 in 2007 he decided to wait despite being advised to sell and book profit, at least partially. The stock started going down in the bear market in 2008 and after waiting for more than year through a bear market he got tired and sold the stock at Rs 200 while claiming that he was able to protect his capital.

This is a mistake many people make particularly when they are credited with identifying a multi-bagger stock. Such investors most of times fail to exit at a superior profit as they get emotionally married to the stock and refuse to recognise an impending market peak/trough.

Contrast this with an investor who purchased the same stock at Rs 500 and sold at Rs 1,100. Wrong entry and wrong exit but made huge profit compared to the other investor who entered right and exited wrong.

While it is relatively easy to spot market cycles through a disciplined approach, it becomes extremely difficult for retail investors to do stock picking due to an oversupply of unreliable information. Unscrupulous manipulators abuse information to take unlawful advantage in the market often trapping the innocent investor. Many investors who start equity investment with goals and discipline often end up as speculators but will never accept the fact.

Very few want to be successful traders. Every investor wants to be a successful investor and many of them turn into unsuccessful traders losing their hard earned fortune to hungry brokers.

3.3 CRUDE OIL

Rising oil prices a blessing or a curse?

Oil has rallied recently more than it did at any time during its entire bubble run from 2001-2008. In fact, its current rally of 99% since the low of 12 February 2009 is nearly double the highest 75-days rally during the last oil bull run (from December 2001 to April 2002, oil rallied 55% over 75 days).

During 2001-08 oil bubble, it took 409 trading days to complete the same task from January 2004 to August 2005. While many investors are arguing that oil's rally is a good sign for the global economy and equity markets, let's hope it doesn't revert to the inimical $150. The credit crunch may have sparked the crisis. But it was arguably high oil prices that first pushed the world towards recession by helping to trigger the US slowdown in December 2007. By the same token, it is being explained the fall in oil prices has now helped the world economy back to its feet.

Let us do the arithmetic. Last year, oil prices averaged $100 a barrel. As the world was then consuming some 88 million barrel of crude a day that amounted to a total annualised cost of $3,200 billion. The subsequent collapse in crude prices has cut this year's average by half, to $50, generating an annualised saving of $1,600 billion. Now, compare this to what governments have pledged to spend. Excluding bank bailout, the IMF estimates the discretionary fiscal stimulus provided by G20 countries this year and next will total 2.7% of combined GDP. As G20 output is about $ 45,000 billion, this is equivalent to $ 1,200 billion, or three quarters of the help that lower oil prices have provided in one year alone.

Do oil and stocks trade hand-in-hand? In general, oil and stocks are believed to have an inverse relationship. Looking at data from 1970 through 2008, oil and stocks have a correlation coefficient of minus 0.11, a negligible correlation, smaller than anyone wants to think. However, from 1992 to early 1994, over 20% of the movement in stock prices could be attributed to oil. Unlike previous recessions, oil prices today are much more closely aligned with stock prices, as commodities have become a popular investment vehicle. If you've been following the markets on a daily basis over the past few months, you must have noticed that oil and stocks have been trading hand in hand together. Technically, oil and stocks should be inversely correlated. Clearly speculative traders have entered the oil market in a big way. Abdalla El-Badri Opec's secretary general warned recently that speculators are back to work.

Oil outperforming oil stocks; while the price of oil has risen from the $30s to $70, oil stocks have not really rallied much. Such a dramatic outperformance of oil vis-à-vis oil stocks indicates that oil is probably factoring in a speculative element, and not just health of the economy as widely perceived.

Foundations of oil remain weak. Developed country inventories, for example, cover 62.4 days of demand, one of their highest levels ever, and 14.7% more than a year earlier. US stores of crude are 16.5% higher than a year ago, even though imports are down 6.6%, based on a four-week average. The rising Chinese demand may have more to do with the Chinese government stockpiling oil than an increase in energy consumption. The IEA predicts oil consumption would drop by 2.6 million barrels a day which is apparently the steepest fall since 1982 and considers the present economic recovery as temporary in nature. The World Economic Situation and Prospects 2009 study brought out by the UN recently predicts that the global recession might continue beyond 2010.

It now costs almost 60% more to fill a vehicle than it did at the end of 2008. That is probably enough to knock half a percentage point off consumption. With spare Opec capacity at 7.5 million barrels per day, there's absolutely no reason for such a hurried move in oil prices. Investors' bullish sentiment towards oil could be self-defeating, driving prices so high that they squelch any nascent rebound in demand (for every 10 cent rise in gas price, people can spend $40 millions less a day on other things), and possibly apply breaks to economic recovery. The fundamentals indicate that we are likely to revisit the oil boom and bust scenario witnessed in 2008.

Blockbuster

Global liquidity improves, international investors' appetite for risk increases, and – to crown it all – our country welcomes a stable and active government. The markets have risen to salute these changes. Yet, despite the recent exuberance, investors remain sceptical about whether this milieu of feel-good factors has changed the market's core fundamentals and, indeed, the course of muted corporate earnings. Most have chosen to wait, thinking the current situation will regress and is not the product of a sustainable economic change. They think that the markets will be subdued long after this impulsive exuberance.

4.1 FINANCIAL ADVISORS:
Weigh impact on investors

Robust fundamental growth drivers

We don't believe so. Our belief is grounded on a broader perspective. We believe that the present renewed bull wave resulted not simply from a change in government (sans the Left) but, rather, it is a continuation of the run that began in 2002, triggered primarily by the US-initiated decline in global interest rates and the new globalisation paradigm. These triggers have initiated our Indian growth story and ignited a potent demographic engine that activated consumption due to our people's low financial leveraging. These are the fundamental growth drivers that remain robust.

Since 2002, low interest rates have been the key driver of global economic prosperity and revitalised GDP growth, even in mature economies. In the wake of the US dotcom debacle, the widespread availability of inexpensive funds that followed unleashed latent demand in emerging markets, particularly in India.

The bottoming out of interest rates in 2004 served as a turning point for our GDP growth. Indeed, Indian GDP changed tracks and latched onto a higher growth trajectory even before the sizeable FDI influx that followed, and subsequently accelerated. The share of emerging markets in the global economy increased significantly, from 17% in 1990 to 31% by 2007. Equally significant, their contribution to global GDP growth soared substantially, from 50% in 1990 to 65% in 2007. In the aftermath, the presence of abundant *finances,* favorable *demographics*, and sufficient *innovation* from developed countries yet to be absorbed means that emerging economies – especially China and India – will witness robust growth.

Of the three essential engines that drive conventional economic growth – *population growth*, *financial leverage* and *innovation* – the availability of affordable finance became scarce after the last September's Lehman Brothers collapse in the US. But, the US government pressed for colossal bailouts, resulting in huge dose of liquidity. The massive printing of money was deemed the preferential route to provide more liquidity for global central banks. A flurry of QIPs and the strength of FII inflows are just the beginning and it is likely that a large amount of cheap foreign capital – potentially, as much as $50 billion – will flow to India in the coming quarters. With foreign players investing again, foreign capital flows have turned positive in India, alongside our inherently strong domestic savings.

As a result of the lower interest rate regime and under-penetration of housing and mortgages, rapid credit growth in this segment will likely cause a significantly higher GDP growth nationwide. Mortgages penetration in India is only about 6% of GDP, which is less than 1/10th the levels of developed countries like the US (75%) and the UK (100%). In fact, the housing sector's contribution to overall GDP peaked at just 3% in FY06, while in the US it has averaged about 10% over the past decade. Furthermore, the availability of cheap funding to the private sector is even expected to generate new projects under the PPP model, supported by effective viability gap funding from the new government.

4.2 WEALTH MANAGERS

Map out the details to translate into benefits: **Inflows to global market reviving**

The worst is over

The global financial meltdown, which followed last September's Lehman Brothers collapse, is narrowing helped by unprecedented synchronized policy actions. Global equity markets have revived from the lows of March '09 and extreme risk aversion in credit and interbank markets has ended. Spreads have receded somewhat to pre-Lehman levels accompanied by renewed issuance in global bond markets.

The pace of output contraction in mature economies has moderated with a trough in April. Labour market indicators are turning less negative as exemplified by US employment numbers for May. The gradual waning of the global crisis is positive for emerging market finance.

The sharp retrenchment in capital flows from late last year appears to have recently come to an end. Portfolio equity investment has turned positive from April while sovereign and investment-grade borrowers are beginnings to return to global capital markets. Purchases of domestic debt securities have resumed. Foreign direct investment has been stable, but international bank lending remains depressed.

The Institute of International Finance's recent report on 'Capital Flows to Emerging Market Economies' projects that net private flows will bottom out at a seven-year low of $140 billion in 2009, after falling to $392 billion in 2008 from a record $888 billion in 2007.

As a percentage of emerging market GDP, net private flows fall from a peak of 6.6% in 2007 to only 1% in 2009. Due to deleveraging, capacity adjustment and more realistic risk pricing compared to the pre-crisis boom, the new normal level for private flows may be 2-3% of GDP, over the near term.

But, Asia leads among emerging markets. As a percentage of the total for all emerging markets, Asia's share rises from the a third in 2007 to 63% in 2009. The jump in 2009 will reflect the sharp retrenchment in flows to Eastern Europe, Russia and Turkey, which are also set to experience output contraction of 7%.

In contrast, real GDP growth in Asia falls from 9.9% in 2007 to 5% in 2009, led by China and India with large home markets. In addition to the somewhat more favourable global backdrop, capital flows to India are being bolstered by the re-election of the Congress-led government. To sum up, although we are unlikely to return globally to the pre-crisis boom, the worst is over and Asia will lead the recovery.

Net private flows had reached a record $90 billion in the fiscal year ending March 2007 before retrenching $8 billion in 2008-09, but are set to rebound in 2009-10 and 2010-11. India is well placed with new government, renewed confidence and fundamentals to capitalise on a domestic-demand-led growth revival to 6.5%-7% this fiscal and 7-8% next fiscal facilitated by greater capital inflows.

Absence of inflationary pressures should allow policy rates to be kept low. Favourable market conditions and capital inflows should also accommodate the large near-term budget financing needs without crowding out the private sector, although fiscal adjustment needs to be reinstated once the economy revives. The government has a **unique opportunity** to make a transformational change in its five-year term through bold and credible policy actions to address structural impediments, including jump starting infrastructural investment and curbing unproductive expenditures.

4.3 CREDIT COUNSELORS

Resolve convertibility and recompensation issue: Mitigating global financial crisis

Foster real opportunities

It is now clear that the global financial and economic crisis has affected the developing countries very badly. While the so called 'green shoots' of recovery are beginning to be spotted, the crisis of such proportion needed global response. To be fair, the international community has responded to it in a sprit of cooperation and to contain further deepening of the crisis.

In October 2008 itself the president of the UN General Assembly appointed a *Commission on Reforms of International Monetary and Financial System* chaired by Nobel Laureate Professor Joseph Stiglitz and with senior experts from different regions including Dr Y V Reddy, the former governor of the RBI. The G-20 leaders met in Washington DC in November 2008 and in London in April 2009 to chart out a global plan for recovery and reforms. **The UN Conference on the World Financial and Economic Crisis and its impact on Development** held on 24-26 June 2009 with leaders and ministers of many countries and adopted an outcome document containing some proposals for addressing the concerns of developing countries, specially the poorer and smaller ones not represented in G-20.

The two initiatives need to be seen in a complementary manner. The G-20 process addressed the most immediate task of restoring confidence and assisting recovery by providing a package of $1,100 billion at the disposal of international financial institutions and multilateral developing banks to restore lending. The UN Conference being able to bring together nearly all of the humanity came up with a more inclusive and comprehensive agenda for action in the medium and longer term. It was able to highlight the challenges faced by developing, especially the poorer countries underlining, for instance the plight of developing countries with the sudden reversal of private capital flows, large and volatile movements in exchange rates, falling revenues and reduced fiscal space for taking corrective measures.

It called for a coordinated and comprehensive global response focusing on restoration of the flow of **development finance** without unwarranted conditionalities and **debt relief** to developing countries for 'fostering an inclusive, green and sustainable recovery'. It also emphasised on the importance of **South-South cooperation** and **triangular cooperation** for assisting the developing countries in recovery. It also emphasised the importance of the long pending reform of **international financial architecture** to enhance the voice and participation of emerging markets and developing countries and acknowledged the importance of examining the calls for reform of **current global reserve currency system**. It recognised the importance of **regional financial cooperation** and its potential to complement global initiatives.

It is now time to act on these important proposals. In particular, the Asian region has some real opportunities for financial cooperation speeding up their recovery and restoration of rapid growth path. Asean+3 countries have recently created a multilateral pool of foreign exchange reserves amounting to $120 billion. There is a need to build on this initiative in terms of scope and coverage. With over four trillion dollars in forex reserves, the Asian region now has the resources to foster a major programme of regional Keynesianism building regional infrastructure and other public goods through catalysing private public partnerships while facilitating mutual trade by creating a unit of account such as an Asian currency unit and providing balance of payment support. The generation of additional demand in Asia will not only assist the recovery in the region but also of the global economy.

To conclude, therefore, time has come to take the proposals on international and regional cooperation in the area of finance to the next level. As the emerging centre of gravity of the world economy, Asia should take the lead in exploiting the potential of regional financial cooperation for generating additional demand for expediting the recovery of the world economy from the worst crisis since the Great Depression.

Reform Investment policy

The world economy is going through one of its worst downturns since Great Depression. Even the ever-fast-growing China has begun to show signs of slowing down. And the latest champion of the GDP growth race, India, also has to do with 7% growth. The Institute of International Finance has predicted that world investment flows will see a rapid fall, by as much as 30% in 2009. In this scenario, only those economies which provide sure growth opportunities and present a dynamic, investor-friendly policy environment can expect investment flowing their way.

India needs huge amounts of investments to sustain and improve its growth performance. India's mainstay of growth the last several years has been a phenomenal rise in investment: the investment - GDP ratio going up from 22.8% in 2001-02 to an estimated 37.5% in 2007-08. The same growth in investment is almost impossible to sustain without a major policy initiative. Given all this, India must embark on a second journey of economic reforms targeted at improving the investment climate, focused on fixing the policy environment and removing obstacles to business. India must, once again, as it did in 1992, send a powerful reformist signal to the world. It is time for unleashing a second wave of economic reforms.

The prevailing investment environment is characterised by a complex, burdensome tax structure, inflexible labour laws, bureaucratic delays, discretionary interpretation and vested interest, high cost of entry and exit, and ineffective/slow dispute resolution. There is no single agency to act as facilitators for foreign investors. There is no investment law in place that could provide guarantees to investors. Given that labour laws are not within the jurisdiction of the central government, the focus of the government must be on microeconomic reform efforts in two key areas: **tax** *and* **investment policy**.

India did remarkably well from 2004 to 2008, under stewardship of finance minister P Chidambaram, to grow the central government's tax-GDP ratio from 9% to 13.5%. However, the tax reforms concentrated on raising revenue and were not entirely investor friendly. An investor-focused approach would consider options to reduce compliance costs, and attract new investment. It is now time for initiating just such tax reforms which reduce compliance costs and increase ease of doing business.

On the investment policy, what is needed is a clearer statement of policy and a strong institutional mechanism that can attract and retain foreign investment. The Investment Commission pointed out that one of the most important reasons FDI remains lower than its potential is that some sectors that attracts the most investment around the world, for e.g., finance, are relatively closed in India. There is a need to revisit the FDI regime. One suggestion is to remove sector caps and entry restrictions in all sectors other than those which are "strategic". In sectors dominated by public sector units, there is a need to create a level playing field. In key sectors independent regulatory institutions must be established.

India must have a dedicated, single-window, high level investment promotion agency, which also looks into issues of "investor after-care". Investors, both domestic and foreign, complain of lack of coordination between central and state governments, so, often, while their projects are accorded approvals, they did not take off on the ground. An effective Centre-state resolution mechanism, akin to the Empowered Committee for VAT implementation, could be set up to resolve foreign investor issues. A special high level fast track mechanism could be put in place for priority sector projects. The next wave of investment policy reforms must focus on removing barriers to investment and providing effective investment promotion mechanisms. Microeconomic reforms are the bedrock of an investment-oriented, high growth economy. We can expect the UPA government would unfurl the second wave of reforms.

Perils of protectionism

Western countries are responding to the global economic meltdown by adopting protectionist policies. Spearheading the new wave of protectionism or isolationism is the US government. Firms and banks receiving the rescue funds from the US government may face restrictions in hiring foreign workers. Similarly, 'Buy American' clause imposes restrictions on the use of non-American material in all public works programmes that will be funded by the stimulus package.

Similar protectionist policies are being pursued by European governments as well. Governments pouring funds into banks to keep them solvent are insisting that those funds be used nationally. In Britain, politicians as well as labour union leaders were chanting the nativistic slogan 'British jobs for British workers.' The French government has asked its auto manufacturers to reduce production abroad and increase production in France.

The aim of these protectionist slogans and policies is to keep jobs and capital within national boundaries and help local economies. Alas, protectionism will not trigger economic growth nor bring an end to what has been widely labeled as the worst recession since the Great Depression.

If past is any guide, it may delay recovery as happened in 1930, when in the midst of the Great Depression, the US government passed the Smoot-Howlet Act that imposed high import duties on approximately 3,000 foreign goods. In response, European countries retaliated by imposing equally high tariff duties on goods manufactured in the US.

The result was a deepening of the recession in both the US and Europe.

Protectionism will increase cost of production and result in an inefficient allocation of resources.

In the short run, it will increase demand for goods manufactured by local producers. But it will trigger retaliations from trading nations. On balance, while some domestic producers will benefit from higher tariffs, others will lose on account of retaliatory actions by importing countries.

In the long run, protectionist policies will reduce global competitiveness of local manufacturers. It will protect inefficient industries that cannot compete internationally, but efficient and competent industries would be on the losing end.

Steel manufactures, for instance, may benefit from the 'Buy American' clause, but high-tech companies like Microsoft, Intel, Apple, General Electric and Boeing may suffer in retaliation China, India, Brazil and America's other trading partners impose tariffs on goods produced by these companies.

The answer to the global economic mess is not isolationism. Indeed, isolationism is not possible in many sectors. Consider for instance, the auto industry, the US government has provided billions of dollars to rescue the American car industry. Germany, France and Sweden also have similar, though smaller, rescue packages for their car companies. However, most of the car manufacturers have global businesses, and rescuing an automobile company in one country would affect its operations in other as well.

4.6 TECH SAVVY PROFESSIONALS

Take first step to ensure efficient and reliable system

Perils of technological innovations

Technology is the greatest driver of modern life. Financial markets have embraced it wholeheartedly to leverage the speed of transactions. The fastness of technological innovations aided the mesmerizing rise of finance capital. It brought speed that was thrilling till it took the flights of fancies. The global financial crisis reminded all of us that simple adage that speed not only thrills but kills as well.

The technology can be both transparency enhancing and 'opaque' at the same time. Ironically, it can reduce and increase information asymmetry. It can increase information asymmetry at a practical level because there are limits to human brains to absorb and act on the huge amount of information released by high-technology-aided markets. Information may be available but not consumable or fully digestible. Because the speed and magnitude of the information flow is simply mind-boggling, identifying the right information has become almost impossible. We are facing a world of 'plenty' here. It is not a menu of choices but a huge avalanche that has to be negotiated in flash of a second.

Since brain is not able to match this mad race, financial markets have turned more techno-savvy even in areas that need human touch. So they invented sophisticated mathematical models for trading: models to substitute judgments. So mechanisation of brain is the result – a sort of conveyor-belt approach to financial decision making process. This has converted human beings into robots with a pre-set target of fast growth accumulation. This growth in the immediate run has made everyone a 'tiger-rider'.

We remember the story of a fictional tiger-rider, a simple man burdened by the weight of his 'creating' a god. He did this by using a very simple technique of putting dry grains in a pit, placing an old statue above it and covering with soil. And when he poured water, the grains expanded and pushed up the 'god' and a miracle was born. Are we creating such false gods and becoming tiger-riders? Do we carry the weight of conscience or ride the glory our immense power of creating demi-gods? These are questions that transcend the boundaries of the financial world and need a wider spectrum of knowledge to answer. Or we may have genuinely no answers to them.

Look at the way the human robots are treated these days in the labour markets. Almost all are temps, having no attachment to their organisations. The top management prefers to be temps by choice, others by design. Everyone is motivated by bigger and faster results to sustain themselves. A brave new world of broiler chickens! Earlier they used to talk of quarter to quarter life, now it is moment to moment. Who cares about the long term consequence! No wonder, edifices turn into house of cards! This maddening race for constructing houses of cards has put the economy and society in peril.

Regulators and policy makers are supposed to be constructing structures to protect the edifices, however brittle they may be, for generating the right incentive alignment and by exhorting the robots not to make house of cards. The regulators' dilemma, in the world of billion entities, is how to bring about that desired alignment when each one lives in an island unto himself. And wanting to grow like broiler chickens? Can regulator cope up with the speed of robotic motives and speed? Can they create rules and laws to take care of the speed of the avalanche? These are practical questions which got tested in the current financial crisis. They realised that the leisure of time, which used to be a policy tool in the past – was gone.

In our quest for momentary glory when almost everyone is ready to be a tiger-rider travelling at the speed of sound (and wanting to accelerate to the speed of light) perhaps the only rule that the regulator could yell out was to request the players to wear seat belts. Thereafter, the regulators could close their eyes and pray that the players reach maximum speed, stillness, and equilibrium.

The Chinese money

Zhou Xlaochuan, governor of the People's Bank of China (PBOC) proposed to replace the dollar as the world's major international currency. In a paper Zhou argued that today's crisis reflects "the inherent vulnerabilities and systemic risks" of the dollar-based global economy.

It may surprise Americans that, up to a point, his analysis is correct. The dollarized world economy developed huge instabilities – vast trade imbalances (American deficits, Asian surpluses) and massive, offsetting of international money flows. But Zhou's omissions are equally revealing. To wit: China is heavily implicated in the dollar system's failings. By keeping its currency artificially depressed – as an aid to exports – China abetted the very imbalances that is now criticises.

The Chinese denounce American profligacy after promoting it and profiting from it. Low prices of imported goods (shoes, computers, TVs) encouraged overconsumption. From 2000 to 2008, the US trade deficit with China ballooned from $ 84-b to $ 266-b. China's forex are now an astounding $ 2 trillion.

It's not just the exchange rates were (and are) misaligned. American economists have argued that a flood tide of Chinese money earned from those bulging trade surpluses depressed interest rates on US Treasury securities and sent investors searching for higher yields elsewhere. That expanded the demand for riskier securities, including subprime mortgages, and pumped up the housing bubble. So China policies contributed to the original financial crisis, though they were not the only cause.

For decades, dollars have lubricated global prosperity. They're used to price major commodities – oil, wheat, copper – and to conduct most trade. Countries such as Thailand and South Korea use dollars for more than 80% of their exports. The dollar also serves as the major currency for cross-border investments by governments and the private sector. Indeed, governments hold almost two-thirds of their $ 6.7 trillion in foreign exchange reserves in dollars. But over reliance on the dollar can also backfire, as it now has. Not only have countries suffered declines in exports to a slumping US economy. They've also lost dollar loans needed to finance trade with third countries.

Given the dollar's drawbacks, why not switch to something else, as Zhou suggests? The trouble, as even he concedes, is that there's no obvious replacement.

The attraction of an international currency depends on its presumed stability, what it will buy and how easy it is to invest. The euro (27% of government reserves) and the yen (3%) don't yet rival the dollar. Economist Pieter Bottelier of Johns Hopkins University says, we're stuck with the dollar standards for a while. Countries with huge trade surpluses should reduce the export-led growth that fed the system's instabilities. The Chinese increasingly recognise this. They're very aware of the need to promote consumer spending. In November '08, China announced a $586 billion stimulus. In addition, the government is improving health and pension benefits to dampen households' need for high savings.

But China also has a default position: promote exports. It has increased export rebates; engaged in RMB currency "swaps" with trading partner to stimulate demand for Chinese goods; and stopped the RMB's slow appreciation. China seems comfortable advancing its economy at other countries' expense. Zhou's pronouncement provides a political rationale for predatory behaviour: If we're innocent victims of the US economic mismanagement, then we're entitled to do whatever is necessary to insulate ourselves from the fallout. Down this path lies growing mistrust. Protectionism is rising. Though still modest, they open the door for a lot of other opportunistic measures. And the deeper the recession, the greater the danger!

The Dollar supremacy

Since about 1999, media pundits have been predicting the imminence of two things: break of the US economy and the end of the dollar hegemony. The first has more or less happened now. But for the dollar hegemony, it is not going to end in the near future.

The role of the dollar as the principal reserve currency came in some discussion in the recent meeting of the G20 with suggestions about the need for a second Bretton Woods conference to reform the global financial architecture. While some of these suggestions are politically motivated, it is useful to discuss the economic fundamentals of such issues.

What determines the dominance of a currency in the world trade? Here it is useful to first begin with elementary economics. Any currency, domestic or international, must satisfy three criteria: it must serve as a *unit of account*, *medium of exchange* and a *store of value*. The 1st implies that people accept valuation in that currency, the 2nd that they should be willing to accept that currency in return for sale of goods and services and the 3rd that people should be willing to hold savings valued in units of that currency.

What has been the actual experience? The problem of a *unit of account* other than gold vexed financial planners after the setting up of the Bretton Woods institutions in the late forties. If currencies were convertible to gold on demand then the world supply of currency would depend entirely on discoveries of new gold deposits. Since global liquidity could not be allowed to depend on such fortuitous circumstances, the dollar came to be the principal reserve currency (convertible to gold) under the so called 'gold exchange' standard.

The dominance of the dollar followed the decline of the pound sterling as the dominant currency after the Second World War. The main circumstance that led to this was the Marshall Plan under which the US became the main supplier of goods and services to reconstruct war ravaged European countries. Since the demand was mainly for US commodities, it was natural that the dollar would best serve as the *medium of exchange* in international transactions.

But, as Robert Triffin pointed out, increasing world supply of money depended on increasing US trade deficits and hence something new was needed. This came in the 1960s in the form of the IMF created Special Drawing Rights which became the unit of account in which reserves should be valued. But, SDR could never become a real currency as it could not serve as a medium of exchange; barring IMF quota transactions, all other world transactions were dominated by demand for US goods and hence $.

In addition, the US was the only country willing to become the banker to the world by keeping the value of the dollar fixed in relation to gold (at least till 1971) and so limiting flexibility in domestic monetary policies. The primacy of the dollar comes from the dominance of the US in world production and hence supply of goods and services. Between 1980 and 2007, the US accounted for around 30% of world production. Since most transactions would thus involve the use of the dollar it makes sense for traders to reduce transaction costs by holding dollars.

What about store of value?

It is a telling fact that most countries hold dollar-denominated debt indicating their continuing faith in the dollar as a store of value. So, when would the dollar's primacy end? When world production shifts away from the US subcontinent and some other country exhibits the same degree of political stability. However unfortunate it may seem, the dollar is going to be around for some time to come.

BRIC'S potential

The BRIC concept conceived in 2001 by a Goldman Sachs economist was embraced by the four countries themselves only last year when their foreign ministers met on the sidelines of the Russia-India-China (RIC) trilateral. The expansion of RIC into BRIC through Brazil's addition has created a potentially powerful bloc, given the projections that the BRIC nations could surpass the present leading economies by the middle of this century. Yet it is true that there is little in common among the BRIC states, prompting cynics to call BRIC an acronymic ingenuity with no substance.

In fact, the four countries have little in common, apart from their rapid growth. Not only is China streets ahead of the other three combined, there are vast differences between the latter. Russia's strength derives from its oil riches, Brazil from its commodity (primarily agriculture) exports, India's strength lies in its services while China is a manufacturing hub for most of the world's manufactures. With the exception of Brazil that does not have reason to be suspicious of the other three, there is tension between India and China and between China and Russia that cannot be ignored.

Indeed, while the China-Russia relationship may be on a fairly even keel after years of mutual distrust, the Indo-China relationship is pretty frosty and getting increasingly so as China spreads its tentacles across the sub-continent of Myanmar, Bangladesh, Nepal, Pakistan and now to Sri Lanka where the Chinese are building one of the biggest ports at Hambantora.

Against this backdrop, it was pretty naïve to expect much more than a photo-op from Yekaterinburg.

For all the hype that accompanied the first formal meeting of the BRIC heads of state at Yekaterinburg, Russia, the meet itself ended as might have been expected – on a pretty humdrum note.

This is not surprising. The summit was piggybacked on the Shanghai Cooperation Organisation (SCO) meeting. Such piggybacking may have helped the SCO get more publicity but left BRIC with little space to formulate a unified action plan. Considering that it represents 25% of the earth's landmass and 40% of its population, BRIC needs to emerge as a real bloc.

The world clearly is at a defining moment in its history. In that light, a new forum like BRIC could evolve as important instruments to bring about change in the global architecture. After all, the global institutional structure has remained static since the mid-20th century even as the world has changed fundamentally.

Rather than help recreate institutions for the changed times, entrenched interests already are conjuring up short-term fixes for the multiple crises the world confronts – from the global financial tumult to global warming. To make such interest cede some power, emerging economies need to act in concert.

However, it is too early to predict about BRIC's potential as the US predominance is not likely to fade away soon. The US spent more than $ 607 billion on defence in 2008 and this constitute 41% of global expenditure on defence in its endeavour to maintain global primacy. While American attempts to seek a role in Central Asia, the Caucasus worries the Russians. India fret about US military assistance to Pakistan and the Chinese remain concerned about US involvement in west Pacific and Taiwan. These are the geo-political drivers. It is for good reason that the BRIC combine to concentrate on global economic and financial issues while trying to build an increasingly multi-polar world order.

Crony capitalism, US style

Crony capitalism was a derisive term used by western commentators to run down East Asian countries during the 1997 crisis. But now in a strange reversal of fate, many commentators are pointing a finger at the US, accusing it of the same kind of crony capitalism that was once used to describe emerging markets.

Simon Johnson, former IMF chief economist, in an article written for the *Atlantic* magazine says the crash has laid bare many unpleasant truths about the US, prime among them being how policy formulation has been captured by names in finance. While a great deal of attention has been devoted to the ills of the banking sector, much less attention has been paid to the shift in political balance of power that has resulted in the financial sector getting a virtual veto over public policy, even as it loses popular support.

He points out the biggest beneficiaries of the events that led to the financial crisis, excessive borrowing by households and lax lending standards were commercial and investment banks. Each time a loan was sold, packaged, securitised, and resold, banks took their transaction fees, and the hedge funds buying those securities reaped ever-larger fees as their holdings grew.

So, the financial sector, that never earned more than 16% of domestic corporate profits in the mid 1980s accounted for 41% in the last decade. Salaries also rose dramatically. This great wealth has given bankers disproportionate political weight.

It used this to propound a kind of cultural capital – a belief system. Over the past decade, the attitude took hold that what was good for Wall Street was good for the country. The banking-and-securities industry became one of the top contributors to political campaigns, but at the peak of its influence, it did not have to buy favours the way, for example, the tobacco companies or military contractors might have to. Instead, it benefited from the fact that Washington insiders already believed that large financial institutions and free-flowing capital markets were crucial to America's position in the world.

An important channel of influence has been the flow of individuals between Wall Street and Washington. Robert Rubin, once the co-chairman of Goldman Sachs, served Washington as Treasury secretary under Clinton, and later became chairman of Citigroup's executive committee. Henry Paulson, CEO of Goldman Sachs during the long boom, become treasury secretary under George W Bush. These personal connections were multiplied many times over at the lower levels of the past three presidential administrations, strengthening the ties between Washington and Wall Street. The flow of Goldman alumni placed people with Wall Street's worldview in the halls of power and helped shape policy in their favour.

So much so that throughout the crisis, the government has taken extreme care not to upset the interests of the financial institutions, or to question the basic outlines of the present system. As an example, he points to how the latest US government plan – which is likely to provide cheap loans to hedge funds and others so that they can buy distressed bank assets at relatively high prices – has been heavily influenced by the financial sector. Apart from being unfair to taxpayers, the government's velvet-glove approach with the banks is profoundly troubling because it is inadequate to change the behaviour of a financial sector accustomed to doing business on its own terms, at a time when that behaviour *must* change.

Recovery will not happen unless the US breaks the financial oligarchy that is blocking essential reform. Unfortunately the government seems helpless or unwilling to act against the powerful oligarchs.

4.11 GLOBAL OUTLOOK

Global pathways: Obama's cowardice hits India too

End the recession quickly

India cannot return to rapid growth till the world economy recovers. And that cannot happen till the US economy recovers. Alas, the Obama administration is prolonging the recession by avoiding surgery to remove dead wood from its financial sector. Former IMF chief economist Simon Johnson, writing in *The Atlantic,* says the US now resembles Russia, where business obligations and government's officials protect each others' financial interests, at the expense of the economy.

This is surely an exaggeration. Yet it highlights the priority given by the Obama administration to save the titans of Wall Street rather than end the recession quickly. It is now clear that the toxic assets of US banks are $ 2-2.8 trillion, while tangible assets are only $1 trillion. Technically, the financial sector is comprehensively busted. It needs to recognise the losses, writing off trillions.

The market solution would be to force insolvent banks into bankruptcy, with shareholders and creditors taking a huge hit, and their good assets being auctioned (at bargain price) to surviving financiers. Many titans of Wall Street will disappear, but others will rise to take their place.

While this will clean up the mess, the financial sector will collapse, perhaps converting the recession into a depression. Politicians are unwilling to risk this. Their preferred alternative is to rescue insolvent banks to thwart systemic failure. So, they have provided billions to the very banks responsible for the initial mess. The government views banks as too important to fail. Accounting norms have been tweaked to permit zombie banks to pretend they are alive and solvent. The hope is that the public will swallow this fiction, animal spirits will revive the economy, and the consequent growth of bank profits will eventually suffice to write of the toxic assets. Very optimistic!

The obvious opinion if for the government to temporarily take over the insolvent banks, examine their books and segregate their toxic assets into a "bad bank". This will clean up the balance sheets of the banks, which can start lending again, and then be re-privatised at a profit. This will not be a slide into socialism, and actually makes market sense. The government will aim not to run the banks (as Indira Gandhi did), but to restructure them (as in bankruptcy) and sell them. Even the IMF, supposedly, a free market maniac, routinely suggests temporary nationalisation in such circumstances.

Yet, Obama administration refuses to contemplate this obvious solution. The Wall Street has captured the White House, so nothing will be done to imperil the politico-financial network that rules the US. Robert Rubin and Hank Paulson, treasury secretaries of Clinton and Bush, were both from Goldman Sachs. Larry Summers, the current secretary, earned millions as a hedge fund consultant. In a market economy, well-managed companies should be rewarded with profits. This basic rule has been suspended almost entirely for the titans of Wall Street. Only one titan, Lehman Brothers, has been allowed to go bust, and Wall Street says even that was too much. This is now official policy.

It was once said that what's good for General Motors was good for America. Today, official policy implies that what is good for Goldman Sachs is good for America. This, says Simon Johnson, is a recipe for disaster. He fears that this crony capitalism will lead to a prolonged recession, may be another Great Depression. We see the problem as Obama's cowardice rather than corruption. We don't expect another Great Depression: at worst, the US will suffer stagnation of the sort Japan had in the 1990s. Most likely, we will see a long, weak recovery. Either way, its bad news for India, this badly needs US resurgence.

4.12 ISSUES OF THE PRESENT

Freedom to get & fail in the system of free enterprise

The 'Davos Man' is back, back to his bad old ways

Wall Street types, it seems, is back to their bad old ways. Hiring and poaching is back, astronomical salaries are being justified, and bonuses have just been moved from one part of salary slips to another.

Most bankers are fortifying and planning to return to their profligate ways, sooner than later. Banking big shots are openly pushing back against any attempt to regulate them, cut them down to size, or even change their compensation patterns. The same faces that were trashed last year are propping up elsewhere. And nobody is noticing much, with everyone focused on every sign of economic recovery.

Meanwhile, there's a battle for world domination going on. This battle isn't about investment banks, or hedge funds, or economists or politicians. It's not even about the Swiss, Chinese or India. It's the battle between those who controlled the global economy, through the complex financial system, call him the Davos Man, if you will, fighting to their survival – if kings and Brahmins thought they had a divine right to rule, the Davos Man thinks so too.

The Davos Man isn't just a banker. They're the crony capitalists, with their insiders scattered through regulators, investors, governments, economists, analysts, and media – in every country. So the shake-out of the financial services sector that emerged would not be stronger, more resilient, efficient or cleaner. It would just the dirtier, nastier and even greedier. Because in the job purges that swept through the sector, many of the 'nicer', more ethical, less political people lose out. The more political people survived, the ones, to quote another were, "the worst sort of Hollywood villain types". And this time, they know that there's no penalty for failure, they can always fleece those taxpayers-sheep any time.

Take a look at where, we are on various issues today, for instance global regulatory reforms. The opinion is split 20 different ways, not on how, but if at all. In UK, there's a strong lobby claiming that EU regulatory proposals are just some sort of continental 'land-grab' to topple London's premier financial centre position. There's no consensus within the EU itself. In the US, various lobbies are split right down the middle. The discussion has got bogged down in 'how to evaluate connectivity and risk taking'. Not how to ensure that any corporate entity cannot, in future, hold an entire world to ransom.

Because that's precisely what happened: The political class it seems has been almost frozen by a chill of blackmail. The financial sector just cut off global credit lines, chocking the real economy, until **first** their own jobs, power bases, balance sheets and pay packets were saved. No politician, faced with monthly job loss figures and daily disasters, can withstand that kind of pressure for too long. *Oh give'em back their private jets, at least they'll start lending again.* It is significant that the first rescue package to have any immediate impact were the hugely complicated ones from Geithner that gave plenty of scope for private players to make money, in fees, commissions, and deals. **Next**, take compensation system, even the Obama administration, after its initial ceiling on salaries, has backed down over executive pay. Investment banks and bankers, government funded or not, are back to the merry old bonus system.

Regulators, everywhere, are now divided, among themselves, on what needs to be done. Instead of getting on with the job, most central bankers and regulators are occupied in fighting off rising opposition from the 'let's not mess too much' camp. A senior fellow, from London Business School was quoted in public as saying 'the rush to do something is rather foolish. We have 59 years to get it right'. In that time, lots of people will lose their homes, sink into poverty, lose their retirement nest eggs and suffer horribly and die, while we debate the zeros in a trillion. So, why bother with *Da Vinci Codes* or *Angels and Demons?*

5. BANKING SECTOR

Lessons from financial crisis

These are difficult times. Bankers including former bankers are in deep trouble; and deservedly so; they are the main (though not the only) culprits in creating the current massive financial crisis in the world. No one has ever accused bankers of being particularly bright or hardworking or reliable. Remember the guy who lent you an umbrella in fair weather and took it back when it rained. But now with their over-sized bonuses under public scrutiny, bankers' reputation has touched new lows, somewhere between bandits and thieves. Even the highly respected central banker's actions are being questioned – is a conceivable that Maestro Alan Greenspan may have been affected by irrational exuberance.

Even though public's anger against bankers is justified, the important thing is to learn what mistakes were made, and reform the system to prevent their recurrence. Even more important is to take the right lessons from the crises and not the wrong one. In months and years to come, there would be a great deal of analysis on what caused the current financial crisis. However, there is a fair degree of consensus that extreme excesses in the following areas contributed substantially to it:

In the US, too much money was lent to consumers, far beyond their ability to repay. Consumer credit when used to be 100-150% of the GDP for most of the last century shot up to 300% in the last 10 years.

Size of the banking sector as a whole and individual banks became too large and very highly leveraged. As Simon Johnson, former chief economist of IMF notes in a recent article in the *Atlantic*, the financial sector's profits which used to be around 16% of the total US corporate profits increased to 41% in recent years. Similarly the size of the banking sector in relationship to domestic economy in countries like Iceland, UK and Switzerland became excessively large.

Too many complex financial products were created and distributed. The real risks of these products were not understood by the bankers, rating agencies or the investors. The structured products creators and marketers within the banks became too powerful and the risk managers too weak, so there were no checks and balances.

Bankers were paid too much. We have heard about the obscene bonuses being paid to bankers in the US. Even closer home, in 2007, IIM graduates were getting offers of more than a crore per year from international banks, multiple of what their learned professors are earning.

US treasury secretary Tim Geithner in his testimony to House Financial Services Committee said, "I share the anger and frustration of the American people, not just about the compensation practices at AIG and in other parts of our financial system, but that our system permitted a scale of risk-taking that has created grave damage to the fortunes of all Americans".

To avoid this in future, policy makers should consider the following actions based on the lessons learnt from this financial crisis:

One, the size of the banks should be restricted, so that some of them do not become so big as to endanger the entire financial system. Their activities should be restricted too. They should not be allowed in the investment banking or securities business.

Two, banks all over the world should become a utility to serve the national economy under supervision of the local regulator. Their global expansion should be curbed.

In order to support international trade and capital flows, international banks should be allowed to invest overseas, but only as minority investors. The local regulator should keep close watch so that a trouble in the home country of the home country of an international bank does not result in contagion.

Three, the central banks must act to prevent bubbles. They should expand their focus to control asset price inflation in addition to consumer price inflation. They should take corrective steps if there is excessive credit growth overall and in any particular sector of the economy.

Four, the capital adequacy requirements of the banks and other financial institutions should be further increased. Banks should adopt dynamic provisioning policy, (as in Spain) to provide higher credit provisions and reserves during strong economy, which will act as cushion during recession.

Five, banks should not be allowed to accumulate any risk through off balance sheet structures. All risks must be included in ascertaining capital adequacy. Innovation in banking should be encouraged, but in areas such as use of technology and other means to serve its customers better. In India and in most developing countries innovations should target to include the unserved or under-served population into financial system.

Six, the whole system of creation and distribution of structured products needs overhaul. Banks should be asked to keep at least half of the assets created by them on their books so that the bank managements are well aware of the risks they are accumulating and distributing.

Similarly the rating agency system needs major correction. Perhaps they should have their skin in the game and not only earn fees and then wash their hands off. Let them also keep 10% of the paper they rate on their books until it matures. It will concentrate their minds to understand and evaluate long-term risks appropriately.

Seven, and perhaps the most important, the compensation of bankers and the risk management in banks require a thorough revision. Bankers' compensation must come down and be in line with what other professionals earn. The bonuses should be downsized and linked to various performance parameters. Private equity offers a good model of long-term incentives: they make money (carry) only if and after their investors have made money. The risk management systems in the banks should be strengthened. While this should be the primarily job of board of directors of banks, the regulators should monitor compensation practices in banks.

This would encourage our best and brightest young people not to chase banking careers and do real work as engineers, scientists, scholars, social workers, etc. As Paul Krugman wrote recently, "Banking should become once again a boring business."

6.1 TAX UPDATES

1. Black money hunt begins

The government has made the first move to track down individuals and entities that have slashed away black money in offshore banks. The Central Board of Direct Taxes (CBDT) has sent notices to at least 50 Indians who have accounts with LGT Bank in Liechtenstein, a tax haven bordering Germany. Tax authorities have sought information on the source of the money lying in the overseas bank and whether the account holders have paid tax on the amounts.

The list, provided by the German government, reportedly contains the names of some of India's most prominent businessmen and industrialists. But the Indian government is under obligation against making the names public as they were provided under the Indo-German Double Taxation Avoidance Agreement (DTAA). The information exchanged under DTAA is confidential but the government is free to act on the information.

In the run-up to the polls, the Congress has repeatedly come under attack from BJP for not doing enough to bring back the black money parked by several Indians in offshore destinations around the world. International media reports estimate, wealth stashed away by Indians could a whopping $1-1.5 trillion.

Indian tax laws have provisions to prosecute a tax offender who refuses to pay even after a crystallised demand. If a person who holds accounts abroad is served a demand notice but declines to pay, (s)he could be invariably prosecuted under I-T laws. Legal experts say prosecution is an ideal tool to bring back unaccounted wealth held by citizens offshore. Senior advocate Mahesh Jethmalani says the prospect of prosecution could be most effective way of recovering such money.

2. Cross-border transactions of trusts taxable

In a verdict that will have a bearing on tax exemptions given to Indian trusts, especially education trusts, the Authority for Advance Ruling (AAR) has held that tax is to be paid in India on all cross-border transactions, even if the parties involved in the transactions are exempt from taxation in their respective countries. In May 29, 2009-order of the AAR was on an application filed by the Chennai-based Sri Ramchandra Education & Health Trust, which has an agreement for obtaining services from Harvard Medical International, which is also exempt from taxation under the US tax laws.

In this application, Sri Ramchandra Education & Health Trust sought to clarify whether tax has to be deducted from the annual fee payable to the Harvard Medical International. The trust claimed before the AAR that since both parties are exempt from taxation in their respective countries, the annual fee payable to the US party is exempt from taxes in India and hence no TDS be deducted from the payment to Harvard Medical International. The I-T department claimed that though Sri Ramchandra Education & Health Trust is exempt from the Indian I-T Act, the US-based Harvard Medical International is not exempt from taxation in India. Further, the I-T department said Trust may be exempt under section 12AA of the I-T Act, which exempts tax on teaching/education activities, but the "annual alliance development and administration/maintenance fees" that the trust has agreed to pay to Harvard Medical International do not come under the classification of payment for teaching or educational purposes.

The AAR held that it is not possible to conclude tax is not payable in India on the payment made to Harvard Medical International merely on the ground that both are exempt from taxation in their respective countries. The AAR stated that various transactions that took place between the parties should be scrutinised thoroughly before determining what proportion of the payment is liable to be taxed in India.

6.2 SECURITY LAWS UPDATES

The ingenious ways to outsmart regulators

It is a cat and mouse game being played out on the bourses with market regulator Sebi acting the cat's part and the manipulators as the mice. Although the cat is now armed with more teeth than before, the mice are getting even more ingenious. In the last few years, the Sebi has banned several prominent market operators for various malpractices. But while the process of establishing guilt and barring the offender are rather straight forward, ensuring that the offender stays away is turning out to be a challenge.

Several banned entities continue to actively trade (and ramp up) stocks, using front entities for their operations. Loopholes in the regulatory framework, the vast size of the market (nearly 3000 stocks traded on a regular basis), and Sebi's manpower limitations, often give manipulators the upper hand. These players are in demand with corporates who want to 'improve' their market valuations through bulk trades, and financiers who are looking for a better return on their investments.

Stock manipulation is as old as the stock market itself. Over the years, technology has made it easier for exchanges and the regulator to zero in on any suspicious activity. But, manipulators too have come up with newer ways to avoid being caught out. And while it may not always be possible to escape detection, these players complicate matters for the regulator so that they are through with their 'operations' by the time the Law catches up with them.

At the heart of any price manipulation is circular trading. The operators have to generate volumes in a stock so as to draw investors to the counter. Usually few players come together and start trading among themselves, thus building up volumes. This attracts new players to the counter. Once there is sufficient liquidity in the stock, thanks to increased participation from retail investors, the operators offload their positions at a profit and move on to some other stock. In the 90s, it was easier for Sebi to crackdown on circular trading. That is because there were just a handful of players involved in each stock. But of late, operators have been covering up their tracks rather well.

An operator looking to ramp up the price of a certain stock, ties up with a dozen odd brokerages. In each of these brokerages, there are another dozen odd clients, which are fronts for this operator. This way, there is little concentration of volumes at any single brokerage house, or in the account of any one client. Through a series of off-market deals, shares from the company promoter's demat account are transferred to the demat account of the front entities controlled by the operator. This mode of transfer of shares is directly from one demat account to the other, and does not show up in the trading volumes on the stock exchanges. After the share change hands, the front entities, who have signed up as clients at different broking houses, then start trading in the shares among themselves.

The most difficult part for the investigator is to prove that all these entities are related. At times, there may be a careless transfer of money between accounts, which is evidence of that these clients know each other and are acting in concert. At other times, there may be telephonic conversations between the clients, which prove that they know each other, and hence the transactions could have been pre-planned. But here too, the manipulators have found a way out. The numbers that these clients mention in the KYC form is not the phone they use for sensitive conversations.

The strategy of these operators is simple – use as many entities as possible and make the chain of transactions so long that it becomes difficult for the regulator to prove a link between the entities. Many of these so-called clients are not regular market players. They are well compensated by the operator for lending their names. So even if they are banned from trading, it means little for them. The operator will then find another set of players for the next stock he plans to manipulate.

7. INFLATION: PSYCHOLOGY MATTERS

Deflation, inflation & in between

To make sense of today's most perplexing economic debate – whether we're flirting with inflation or deflation – it's worth recalling what happened after World War II. Under intense political pressure, President Truman lifted wage-price controls. All heck broke loose. Suppressed during the war, wages and prices exploded. Autoworkers, steelworkers and others went on strike for higher pay. In 1946 and 1947, consumer prices rose 8.5% and 14.4%, respectively.

What's instructive is that prices then stabilised. There was no upward wage-price spiral as occurred in the 1960s and 1970s. True, a mild recession in late 1948 and 1949 helped temper price increases. But inflation subsided mainly because people didn't expect it to continue. They'd lived through the Depression, when prices declined. They knew that, except for the impact of wars, American prices were usually fairly stable.

The lesson for today: psychology matters. What economists call "expectations" shape how workers, managers and investors behave; if they fear inflation, they act in ways that bring it about. The converse is also true, as the late 1940s remind. The lesson provides context for today's debate. Are the Federal Reserve's easy-money policies laying the groundwork for higher inflation? Or will these policies prevent deflation – a broad decline of prices – that would deepen the economic slump?

The questions arise from the Fed's strenuous efforts to contain the economic crisis. It has cut the overnight Fed funds rate almost to zero. It has made loans when private lenders wouldn't – in the commercial paper market, for instance. To lower long-term interest rates, it has pledged to buy $1.25 trillion of mortagage securities backed by Fannie Mae and Freddie Mac and $300 billion of long-term treasury bonds. All these measures are without modern precedent.

Precisely, say the inflation worries. Once the economy recovers, the easy money and credit will spawn inflation. Cheap loans will bid up prices; wages may follow. Low interest rates will encourage spending and deter savings. The Fed will be "under pressure from Congress, the administration and business … to prevent interest rates increasing," warns economist Allan Meltzer of Carnegie Mellon University. With huge deficits, the White House and Congress will want to hold down borrowing costs. So Inflation psychology will strengthen.

Nonsense, say deflation worriers: Inflation results mainly from too much demand chasing too little supply. Today, too much supply chasing too little demand. High unemployment and slack business capacity (idle factories, vacant office suits, closed mines) impede wage and price increases. If the Fed doesn't maintain cheap credit, shrinking demand might cause prices and wages to spiral down. "Deflation, not inflation, is the clear and present danger," reports Princeton economist and *New York Times* **columnist Paul Krugman.**

It seems impossible for both arguments to be correct; but they may be. As economist Krugman notes, Inflationary pressures are almost non-existent. In the past year, the Consumer Price Index has been roughly stable. In May, unemployment rose to 9.4% from 8.9% in US. A survey by Challenger, Grey & Chrismas found that 52% of firms had frozen or cut salaries. GM's bankruptcy is but one indicator of excess industrial capacity. The surplus is worldwide, finds a study by Joseph Lupton and David Hensley of JP Morgan. Inflationary expectations are low.

All this gives the Fed maneuvering room. Expectations matter; inflation won't burst forth instantly. Even Meltzer doesn't see an immediate surge." When will it come? Surely not right away," he writes.

Still, Meltzer's warning remains relevant: The Fed has often overdone expansionary policies and fostered inflationary expectations. In the 1960s and 1970s, that occurred through exchange rates and commodity prices. Inflation fears could raise prices of commodities (oil, metals, foodstuffs) and depress the dollar. Imports would become costlier, allowing domestic producers to raise prices. Once inflationary practices take hold, high inflation and unemployment can coexist: dreaded "stagflation." In 1977, both inflation and unemployment were about 7% in US.

There's evidence (better housing and auto sales, strong growth in "emerging markets") that the danger of a deflationary economic free fall is ebb. Someday, the Fed will have to raise interest rates. Fed chairman Ben Bernanke has pledged to pre-empt high inflation. Will the Fed get the timing right and resist contrary political pressure? Will the pledges reassure markets?

One reason they might note is that Bernanke's term as chairman expires in January. Any replacement named by President Obama would be seen, fairly or not, as more beholden to the administration. The president could eliminate that perception by offering Bernanke – who has performed well in crisis – a second four-year term and, if he accepts, announcing the reappointment. That would not settle today's deflation-inflation debate. Only time will do that, but it would remove a needless uncertainty.

Inflation at 33-year low goes down to 0.13%

Inflation for the week ended **May 30** dropped to 0.13%, lowest since the government started recording such data in 1977-78, fuelling speculation that the figure could enter negative territory next week. This should address fears on any immediate spike in overall inflation, for the time being, but the sharp week-on-week increase in prices of food articles is worrisome. The decline in the headline inflation was largely due to the high base effect – or higher inflation numbers in the corresponding week last year.

Inflation turns negative -1.6%, but no warning bells yet

Finally, we have a negative inflation number. The wholesale price index for the week ended **June 6, 2009** fell by 1.61% from a year ago, provisionally. This is the first fall since December 1978, and is largely due to the high base effect caused by the sudden jump in prices last year. Inflation was rising at an accelerated pace early June last year, driven by the sharp rise in prices of fuel and power as well as manufactured goods. The WPI had reported a 11.7% rise for the week ended June 7, 2008. The situation has dramatically changed since then. Growth collapsed globally with many countries slipping into a recession. And this cooled commodity prices, including that of petroleum products.

Earlier this year when the rise in inflation began to ease, some feared that India could slip into deflation. Indeed, that was an exaggerated fear, although the pace of growth slowed. Even the latest set of inflation numbers should not fuel any such concerns, Anecdotal evidence suggests that demand is reviving, much of it due to the three fiscal stimulus packages and cheaper cost of borrowing. Indeed, many economists have dismissed the negative number as a statistical phenomenon. The declining inflation may persist for a few weeks due to high base last year.

The country's chief statistician Pranab Sen, who was the first to predict a negative inflation scenario in the country, says this negative inflation scenario is not going to hurt anyone and it is completely different from the deflation that we witnessed 33 years ago. "Then the deflation was driven by an extremely good harvest season and a subsequent drop in food prices to record lows. This time, the negative inflation will have a positive impact on growth." The manufacturers stand to benefit as the prices of inputs are coming down at a faster pace than fall in prices of finished goods. The domestic consumption demand remains strong even at a time when the demands from overseas and private investments have fallen.

Few trust the inflation numbers announced by the government every Thursday. There are reasons. Even though wholesale price inflation has entered into negative territory, inflation in terms of daily use, such as grains, fruits and vegetables continues to remain in double digits in the WPI. While the foodgrain basket in the WPI has gone up by almost 14% year-on-year in the week ended June 6, the fruit and vegetables basket has gone up by almost 10%. Overall, food article inflation is up by 8.6%. The impact of such steep price rises in items such as foodgrains and fruits and vegetables, is not fully captured at the wholesale price level because of the relatively low weightage, 15.4%, of food articles in the WPI. Of this, foodgrains comprises 5.01% and fruit and vegetables 2.92%.

Inflation rises to -1.14%, price pressure mounts

Even as the WPI-based inflation remained in the negative for the second week running at 1.14% for the week ended **June 13**, the sharp spike in the price index in the week under consideration suggests that inflation pressures may be building up. Economists pointed out that even though wholesale prices were below their levels last year, a situation being widely described as deflation, India was already in a high inflationary environment. While retail inflation, as measured by various consumer price indices, is already back in double digits, pressure is also building up on wholesale prices.

Economists also pointed out that the negative annual inflation is largely because of the base effect – measured against the high index values for the last year, the annual rate of inflation is turning out to be negative. This is masking the immediate inflationary pressure even at the wholesale levels. They expect the base effect to keep the WPI inflation in the negative territory for close to two months.

Inflation falls to -1.3% despite costlier food

Inflation rate for the week ended **June 20** fell by 1.3% compared with the year ago period, despite a week-on-week increase in the prices of food items, manufactured items and fuel items. This is due to high base effect of high annual inflation of 11.91% in the year-ago period. Analysts point out that while prices of manufactured items may have bottomed out, food prices can move down further as the monsoon rains have revived in the past few days.

Petrol prices hiked by Rs 4/L, Diesel Rs 2/L

The government increased the price of petrol by Rs 4 a litre and diesel by Rs 2 a litre with effect from midnight of 1st day of the next month (July 2009). Cooking gas and kerosene were left untouched.

Significantly, the hiking of retail fuel prices on the eve of the Budget paves the way for the government to perform two kinds of fiscal reforms. One, include fuel subsidies in budgetary accounting, instead of fudging the figures by counting oil bonds meant to finance fuel subsidies as off-budget items. Two, still keep the now expanded fiscal deficit down, by reducing the amount of subsidy on retail fuels.

The last time auto fuel prices were increased was on June 4, 2008 and that was followed by two quick rounds of price reduction in December 2008 and January 2009, well before the general elections were announced, as global crude prices came down sharply. As a result, petrol got cheaper by Rs 10 a litre and diesel Rs 4 a litre.

8.1 MISCELLANEOUS UPDATES

Accepted bet

There is near-universal consensus that America's monetary authorities made three serious mistakes that contributed to and exacerbated the financial crisis. The consensus is that US policymakers erred when:

- The decision was made to eschew principles-based regulation and allow the shadow banking sector to grow with respect to its leverage and its compensation schemes, in the belief that the government's guarantee of the commercial banking system was enough to keep us out of trouble;

- The Fed and the Treasury decided, once we were in trouble, to nationalise AIG and pay its bills rather than to support its counterparties, which allowed financiers pretend that their strategies were fundamentally sound.

- The Fed and the Treasury decided to let Lehman Brothers go into uncontrolled bankruptcy in order to try to teach financiers that having an ill-capitalised counterparty was not without risk, and that people should not expect the government to come to their rescue automatically.

There is, however, a lively debate about whether there was a fourth big mistake: Alan Greenspan's decision in 2001-2004 to push and keep nominal interest rates on US treasury securities very low in order to try to keep the economy near full employment. In other words, should Greenspan have kept interest rates higher and triggered a recession in order to avert the growth of a housing bubble?

If we push interest rates up, Greenspan thought, millions of Americans would become unemployed, to no one's benefit. If interest rates were allowed to fall, these extra workers would be employed building houses and making things to sell to all the people whose incomes come from the construction sector.

Full employment is better than high unemployment if it can be accomplished without inflation, Greenspan thought. If a bubble develops, and if the bubble does not deflate but collapses, threatening to cause a depression, the Fed would have the policy tool to short-circuit that chain.

In hindsight, Greenspan was wrong. But the question is: was the bet that Greenspan made a favourable one? Whenever in the future the US finds itself in a situation like 2003, should it try to keep the economy near full employment even at some risk of a developing bubble?

We are genuinely unsure as to which side we come down on in this debate. Central bankers have long recognised that it is imprudent to lower interest rates in pursuit of full employment if the consequence is an inflationary spiral. And it carries the risks causing an asset price bubble. However, we think that even with the extra information we have learned about the structure of the economy, Greenspan's decisions in 2001-2004 were prudent and committed us a favourable and accepted bet. Since, the market interest rate was above the natural interest rate in the early 2000, at that time the threat was deflation, not accelerating inflation. So, Greenspan's decision in 2001-2004 to push and keep nominal interest rates on US treasury securities was an accepted bet.

You can argue that Greenspan's policies in the early 2000s were wrong. But you cannot argue that he aggressively pushed the interest rate below its natural level. We don't think that Greenspan' failure to raise interest rates above the natural rate to generate high unemployment and avert the growth of a mortgage-finance bubble was a mistake. There were plenty of other mistakes that generated the catastrophe that faces us today.

Deals to trigger a fresh wave of mergers

1. BlackRock's BGI deal

American asset managers woke up to a reordered world on Friday (12/06/09) after BlackRock and Barclays Global Investors inked a blockbuster deal that may prompt many of them to consider mergers of their own. BlackRock, already the largest publicly traded US money managers with $1.3 trillion in assets, will pay $13.5 billion for BGI's $1.5 trillion in assets.

The deal puts a huge distance between the new company and its closest rivals, State Street Corp with $1.4 trillion, and privately held Fidelity Investments with $1.25 trillion. Fidelity is no longer the industry's 800-pound gorilla. Industry analysts said, "We now have a new 16,000-pound gorilla. For the industry's biggest players, including Bank of New York Mellon and Vanguard, the move could hasten talk about how best to compete with the New BlackRock Global Investors in products like index funds and exchange traded funds where scale matters and that trade like stock".

Analysts have long expected a fresh wave of mergers among fund managers after many were badly battered by last year's financial crisis that cost them, billions in lost assets and forced thousands of job cuts. So, there are a lot of managers interested in acquiring something and building out the investment areas they don't have. Bank of New York Mellon was also interested in BGI, and because the company is flush with cash, some analysts speculate it may be next to announce a deal. Analysts wouldn't be surprised if they do something big relatively soon.

2. Sesa Goa scoops Dempo Mining

Sesa Goa, the country's largest private iron ore exporter, has bought Goa-based VS Dempo Mining Corporation for Rs 1,750 crore in order to further consolidate its position in the industry. A part of London-listed Vedanta Resources, Sesa Goa will fund the transaction from its internal resources pegged at around Rs 4,000 crore. The acquisition will provide operational synergy to Sesa Goa as Dempo's mines are adjacent to its assets in India's smallest state. Sesa Goa has mines in Karnataka, Orissa and Goa. Also, Dempo is a well known exporter of iron ore in China where Sesa Goa has also got a significant presence. The acquisition of the unlisted company, which owns 19 mining leases spread over 1,800 hectares in Goa, will add 70 million tonnes of reserves to Sesa Goa's 240 million tonne. Last year, VS Dempo has posted a net profit of Rs 400 crore on a top line of Rs 1500 crore.

The acquisition takes place when the major iron ore miners are gearing up to command more pricing power in the wake of fresh rounds of consolidation in the global iron ore industry. Rio Tinto and BHP Billiton are merging their Australian assets to form a firm with an annual production capacity of 250 million tonne. These consolidations of supply will strengthen the pricing power of miners. Sesa Goa, which was acquired by Vedanta from Japan's second-largest trading company Mitsui two years ago, has posted a net profit of Rs 1,995 crore on net sales of Rs 4,959 crore in FY09. The Vedanta group seems to be in a buying mode. Sterlite Industries, the group's mining company in India, has signed an agreement to buy US-based copper miner Asarco for $1.7 billion.

3. Fiat closes Chrysler deal

Fiat closed its acquisition of Chrysler's strongest assets on Wednesday (10/06/09), a key step in the Italian carmaker's ambitions plan to create a global player to ride out the worldwide auto sales downturn. The Fiat and Chrysler deal revives the 84-year old US automaker that had been down to its last dollars before government intervention in late 2008 and completes an Obama administration-directed fast-track reorganisation for Chrysler. Other parts of Chrysler will remain in bankruptcy to be sold or closed.

8.2 INSURANCE SECTOR

1. Chief Life Insurance Agent Scheme

Life Insurance Corporation's (LICs) year-old scheme to incentivise highly productive agents to recruit new agents has paid off. Over 20,000 agents of the corporations have enrolled over one lakh salespersons. There new recruits have brought in nearly 6% of the corporation's total premium.

A year ago, the corporation had floated the chief life insurance agent scheme (CLIA). Under this, top agents of the corporation were given the choice to become a chief agent who could enroll and mentor new agents under him. His reward would be a small slice of the commission earned by the new agent.

As on mid-June '09, the agents under chief agents brought in Rs 211 crore premium accounting for nearly 6% of LIC's total new business premium. Last year the sub-agents, still in their first year of operations brought in Rs 1,100 crore of premium income.

In the normal course development officers are given the mandate of recruiting agents. Development officers too have targets in terms of the number of agents they need to bring in. However, with agent recruitment plateauing, the corporation decided to use this new route to enroll sales persons.

LIC executive director Nilesh Sathe, who is in charge of the CLIA scheme said, "We felt that since agents were well versed in selling, they would be better placed to identify those with the right aptitude. We have asked each of the chief agents to bring in at least five agents whom they would supervise."

LIC expects that productivity of new agents recruited through this route will be better than average. This year it expects that sub-agents would bring in a premium of around Rs 3,300 crore which is nearly 6.5% of the total premium targeted by LIC for FY10. The corporation is also authorising chief agents to collect premium and issue receipts towards renewal premium. "Although we have close to 50 lakh policyholders making payments online, they represent only one percent of total payments. Even today most of the policy holders stand in queue in bank branches to pay their premium," said Mr Sathe.

2. Irda bars investment in IDRs

Insurance regulator Irda prohibited insurance companies from investing in Indian Depository Receipts (IDRs), the instruments through which foreign companies raise funds from the Indian equity market. IRDA said in a circular that on examination of the features of IDR, it is observed that an investment in an IDR by any insurer would amount to an indirect investment made outside the country and would not be in compliance with Section 27C of the Insurance Act. Section 27C of the Act bars investment of insurance funds outside India. In view of the extant statutory restrictions on overseas investments, it would not be in order for insurers to invest in Indian depository receipts.

Through IDR, foreign companies mobilise funds from the Indian markets by offering their equity shares, in the form of rupee denominated depository receipts. IDRs are listed and traded on the Indian stock exchanges. These receipts are issued to the investors in India against the underlying equity shares of the foreign issuing company.

9.1 KNOWLEDGE RESOURCE

Hon'ble Speaker Meira Kumar

Two years after India created history by electing a woman as its President, another Constitutional post which had so far remained the preserve of men made its way to a woman, that too hailing from the Dalit community, Meira Kumar, daughter of the late Babu Jagjivan Ram, on Wednesday (03/06/09) was unanimously elected as Lok Sabha Speaker.

Prime Minister Manmohan Singh led the members of the Lok Sabha in celebrating the occasion. Describing Ms Kumar's elevation to the post as "a truly historic" moment, he hailed her contributions as a distinguished diplomat, parliamentarian and as an able administrator. He hoped that the experiences gained from all these position would hold her in good stead.

Soon after her formal election, in keeping with the spirit of the occasion, the prime minister, Leader of the House Pranab Mukherjee and Leader of the Opposition L K Advani escorted her to the Speaker's chair.

The 64-year-old leader's election received all-round endorsement. UPA chairperson Sonia Gandhi, Leader of the House, Leader of the Opposition, his deputy Sushma Swaraj, Mamata Banerjee (Trinamool Congress), T R Baalu (DMK), Arjun Charan Sethi (BJD), Sharad Yadav (JD-U), Mulayam Singh Yadav (SP), Lalu Prasad Yadav (RJD), Sharad Pawar (NCP), Farooq Abdullah (NC), and E Ahmed (Muslim League) proposed and seconded her candidature.

Mr Advani, in his speech, recalled his association with her father – both were ministers in the Morarji Desai government – and hoped she'd continue with the glorious tradition bestowed upon her. He assured her of his party's fullest cooperation in discharging her duties.

Accepting with gratefulness the honour showered on her, Ms Kumar said it would be her principal duty to conduct the Lok Sabha in keeping with the Constitution, rules and traditions. She said the assumption of the office of Speaker by a woman was a historic occasion in the 57 years of Parliament, and maintained it had come at a time when the Lok Sabha had elected a record number of women member – 58.

Observing that she was aware of successful tenures of her predecessors from Ganesh Vasudev Mavlankar to Somnath Chatterjee, the Speaker said they had worked to promote the dignity of the post and that she would continue the search for better methods. "I assure the House that I will pay full attention to all sections of the House. I also assure you that neither I will be biased against the Opposition nor I will give any opportunity to the treasury benches to complain," she said.

Speaking to newspersons later in the day, the newly-elected Speaker said that her priorities would be to ensure that the House was able to transact its business for more number of days, and that there were fewer disruptions and adjournments. "I'll speak to leaders of all political parties to ensure more sittings," she said.

Ms Kumar sounded evasive on the question whether in keeping with the tradition established by her predecessors, including Somnath Chatterjee. She would resign from Congress. "A Speaker should be above board and impartial. I'd be completely neutral," she said.

9.2 THE NEW GOVERNMENT

Centre goes to work

Dr Manmohan Inc's team would be any multinational corporation's dream. Resume for resume, its members are in a league of their own. The UPA council of ministers has at least 14 ministers who have graduated from Ivy League universities like Harvard, Wharton, Stanford, and others. There are also Cabinet members who have degree from US universities. Prime Minister Manmohan Singh himself has the distinction of being the alumnus of both Cambridge and Oxford; he has a degree in economics from the University of Cambridge followed by a D Phil in Economics from Nuffield College at Oxford University. Most of these ministers have studied in India before going abroad to broaden their horizon. They are rooted in the reality of the country and have global exposure.

Let's hope it's a ministry of change. Ultimately, performance will matter. The most important lesson is that it's not just good ideas that move the world but the ability to act and translate thoughts into action.

A nation of over a billion people, many of whom have never seen school, is now led by minds honed in the finest universities abroad. And the team Manmohan is in a hurry, and ministers handling key infrastructure portfolios are not shying away from putting a date to their plans. Finance minister Pranab Mukherjee had signaled the collective resolve when he laid rest to all speculations with regard to an interim vote-on-account by clarifying that a full budget will be presented in early July. Now his colleagues handling telecom, petroleum, surface transport, steel and corporate affairs all have laid out their immediate agenda, with deadlines in place, only a day after PM assigned them their portfolios. The continuity of ministers in some sectors – petroleum, civil aviation, telecom, agriculture and urban development – is expected to speed track pending policy measures in these key sectors.

Statements made on the day one indicate that every major minister has significant reforms as a part of his intent. Communications and IT minister A Raja said the long-delayed spectrum auctions for 3G and WiMAX will be carried out before August while his colleague in the petroleum ministry Murli Deora hinted at a deregulation in fuel pricing shortly. Mr Raja felt India has to move fast on the hardware front and he plans to offer a 20% subsidy to companies who have invested in creating a manufacturing hub in the country. In the petroleum ministry, there is also a feeling that this may be the best time to push through the proposed reforms in the oil sector as global oil prices are relatively low.

The man who changed lines from commerce ministry to surface transport, Kamal Nath, said the time for thinking was up, and hinted at some hard action on the ground soon. He said that he will soon start meeting bankers to see that credit for private road builders are made available.

The domestic industry demanded for safeguard duties is the first on the agenda of steel minister Virbhadra Singh, and corporate affairs minister Salman Khurshid is keen on getting the new Companies Act out of the woodworks. Steel minister Singh said that issues related to mining need to be taken up urgently so that projects can be flagged off at the earliest. Corporate affairs minister Mr Khurshid said he was for giving more powers to government's investigation agency – Serious Fraud Investigation Office – that played a significant role in the Satyam case, and emphasised the need to establish good governance.

It was not just about economic infrastructure. Kapil Sibal, who took charge as the HRD minister, said quality and accessibility will be the two pillars on which his education policy will stand.

President Pratibha Patil indicated the government's determination to bring the curtains down on the "chalta hai" approach that has characterised governance all these years.

Addressing the joint session of the two houses of Parliament, Ms Patil reiterated the new government's resolve to dump old ways and encode a new governance principle for those in charge of the levers of power, both political and bureaucratic. The new regime's plans for radical changes in governance constitute a big shift in outlook. If the President's address is anything to go by, the new government does not believe that merely throwing money at problems or offering fantasy panacea across the board from poverty to healthcare to education will keep it in good stead. It has rightly acknowledged the need for institutional changes in governance.

The address to Parliament talked at length on the government's pro-poor policies, and moves to strengthen welfare schemes and boost the economy. There were promises to enlarge the scope of NREGA, which has proved to be an effective social protection measure; introduce a new right to food Act; address the challenges in the health sector such as infant mortality, nutrition and pre-emptive cure; make quality education a right through the enactment of a new law; set up a national literacy mission for women; raise the target of rural housing for the next five years to one lakh twenty crore units; introduce a major housing scheme for the urban poor; and take up initiative for skill development.

The youth could find the new government's agenda more attractive as it has vowed to reform regulatory institutions in the education sector. For long, regulators in the sector such as UGC and MCI have become licence-dispensing machines. "We will set up a National Council for Higher Education as recommended by the Yashpal Committee and National Knowledge Commission for reforming for regulatory institutions." The President said.

President Pratibha Patil while addressing the joint session of the two houses of Parliament on Thursday (04/06/09) also outlined the priorities of new government for the next 100 days:

- Early passage of the Women's Reservation Bill providing for one-third reservation to women in state legislatures and in Parliament.

- Constitutional amendment to provide 50 percent reservation for women in panchayats and urban local bodies.

- Concerted efforts to increase representation of women in central government jobs.

- A National Mission on Empowerment of Women for implementation of women-centric programme in a mission mode to achieve better coordination.

- A voluntary national youth corps which could take up creative social action for river cleaning and beautification programme beginning with the Ganga.

- Restructuring the Backward Regional Grant Fund which overlaps with other development investment, to focus on decentralised planning and capacity building of elected panchayat representatives. The next three years would be devoted to training panchayat raj functionaries in administrating flagship programmes.

- A public data policy to place all information covering nonstrategic areas in the public domain.

- Increasing transparency and public accountability of National Rural Employment Guarantee Act (NREGA) by enforcing social audit and ensuring grievances redressal by setting up district level ombudsmen.

- Strengthening Right to Information Act by suitably amending the law to provide for disclosure by government in all non-strategic areas.

- Strengthening public accountability of flagship programmes by the creation of an Independent Evaluation Officer at an arm's distance from the government catalysed by the Planning Commission.

- Establishing mechanisms for performance monitoring and performance evaluation in government on a regular basis.

- Five annual reports to be presented by government as Reports to the People on Education, Health, Employment, Environment and Infrastructure to generate a national debate.

- Facilitating a voluntary technical corps of professionals in all urban areas through Jawaharlal Nehru National Urban Renewal Mission to support city development activities.

- Enabling non government organisations in the area of development action seeking government support through a web-based transaction on a government portal in which the status of the application will be transparently monitorable.

- Provisions of scholarships and social security schemes through accounts in post offices and banks and phased transaction to smart cards.

- Revamping of banks and post offices to become outreach units for financial inclusion complemented by business correspondents aided by technology.

- Electronic governance through Bharat Nirman common service centres in all panchayats in the next three years.

- A model Public Services Law, that covers functionaries providing important social services like education, health, rural development etc and commit them to their duties, will be drawn up in consultations with states.

President Pratibha Patil quoted Ravindranath Tagore to signal her government's departure from the beaten track on many fronts. The most striking example of this determination to not be stuck in the "dreary desert sand of dead habit" has been in governance reform. The concept itself is new, and deserves all praise in this country that the World Bank routinely ranks at the bottom in the league table of nations when it comes to ease of doing business, thanks to rotten governance.

The President outlined a paradigm shift in governance, to be effected through:-

- One, ongoing, independent evaluation and public reporting of progress in implementing schemes;

- Two, big strides in e-governance;

- Three, decentralisation and empowerment of panchayats and non-government organisations to implement and monitor government schemes;
- Four, breaking barriers between departments and schemes to achieve synergy and integration;
- Five, innovative regulation of health, education and provision of public services;
- Six, liberal use of technology in welfare transfers and achieving public awareness; and
- Seven, institutionalisation of the government's basic commitments by requiring all cabinet notes to specify how their proposals would enhance the goals of equity or inclusion, innovation and public accountability.

A key vision to strengthen the existing right to information into 'duty to publish' on the part of the government, except for matters of strategic importance; the rest of government decision making should be made available in the public domain, without anyone specifically asking for it, so that members of the public can act on the information and hold the government accountable.

President also outlined the broad counters of government's policy on fiscal management: Government will steadfastly observe fiscal responsibility so that the ability of the Centre to invest in essential social and economic infrastructure is continuously enhanced. This will require that all subsidies reach only the truly needy and poor sections of our society. A national consensus will be created on this issue and necessary policy changes implemented.

Opposition promises to not just oppose:

The discussion on the motion of thanks to the Presidential address drew bipartisan support in two Houses of Parliament, with the principal Opposition party, BJP, using the occasion to extend its full support to the Manmohan Singh government.

Leader of the Opposition L.K. Advani told the Lok Sabha, "We are in the Opposition. Let the just-concluded general election mark a new beginning in government-opposition relations. It will have a bearing on the functioning of Parliament." Congratulating Prime Minister and UPA chairperson Sonia Gandhi, he asked the government to perform its duty and said, "We in the Opposition will do ours. Together we can ensure that this century will become India's century. The 2009 verdict is a mandate for stability and bipolarity. The direction is that of stability, and we'd like it to gain strength".

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