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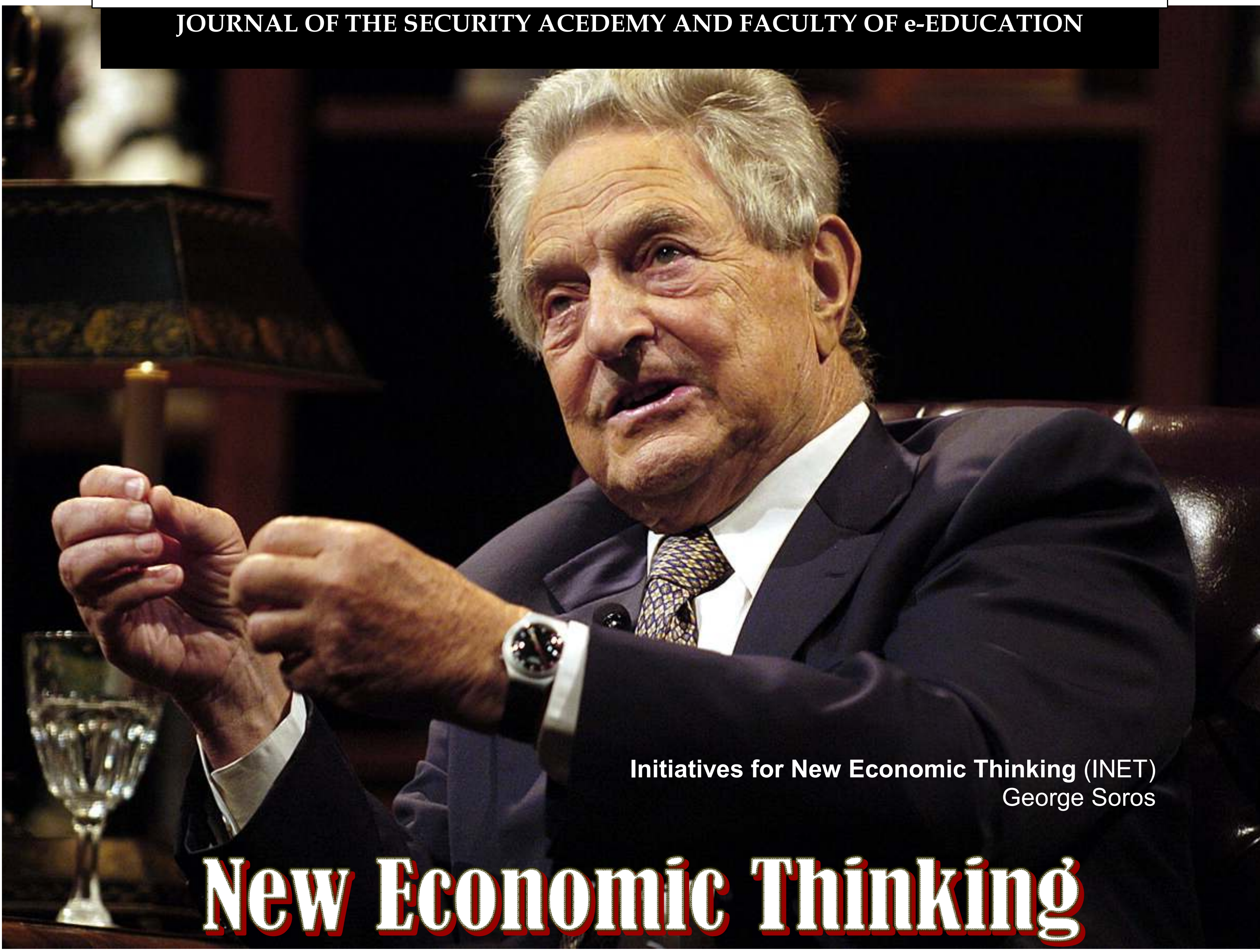

SAFE UPDATES – KEEP INFORMED

The Securities Academy and Faculty of e-Education

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1.1 Editorial Preamble

NEW ECONOMIC THINKING

Let A Hundred Theories Bloom

The economic and financial crisis has been a telling moment for economics profession, for it has put many long-standing ideas to the test. The failure of much of the economics profession to see the crisis coming should be a cause of great concern. There is, in fact, a much greater diversity of ideas within the economics profession than is often realised.

However, economics has generated a wealth of ideas, many of which argue that markets are not necessarily either efficient or stable, or that the economy, and our society, is not well described by the standard models of competitive equilibrium used by a majority of economists.

Behavioural economics, for example, emphasises that market participants often act in ways that cannot easily be reconciled with rationality. A long line of research has shown that even using the models of the so-called "*rational expectations*" school of economics, markets might not behave stably, and that there can be price bubbles. The crisis has, indeed, provided ample evidence that investors are far from rational.

Similarly, modern information economics shows that even if markets are competitive, they are almost never efficient when information is imperfect or asymmetric (some people know something that others do not, as in the recent financial debacle) – that is, always.

Just as the crisis has reinvigorated thinking about the need for regulation, so it has given new impetus to the exploration of alternative strands of thought that would provide better insights into how our complex economic system functions – and perhaps also to the search for policies that might avert a recurrence of the recent calamity.

Fortunately, while some economists were pushing the idea of self-regulating, fully efficient markets that always remain at full employment, other economists and social scientists have been exploring a variety of different approaches. This year's Nobel laureates in economics are two scholars whose life work explored alternative approaches. Much of the most exciting work in economics now underway extends the boundary of economics to include work by psychologists, political scientists, and sociologists.

For all the fanfare surrounding financial innovation, this crisis is remarkably similar to past financial crises, except that the complexity of new financial products and reduced transparency. Our regulators and elected officials were politically captured – *Ideas matter, as much or perhaps even more than self-interest*. They also suffered from intellectual capture. They need a wider and more robust portfolio of ideas to draw upon. That is why the recent announcement by George Soros at the Central European University in Budapest of the creation of a well-funded initiative for New Economic Thinking (INET) to help support these is so exciting. Research grants, symposia, conferences, and a new journal – all will help encourage new ideas and collaborative efforts to flourish.

INET has been given complete freedom – with respect to both content and strategy. Its only commitment is to "new economic thinking," in the broadest sense. Last month, Soros assembled a remarkable group of economic luminaries, from across the spectrum of the profession – theory to policy, left to right, young and old, establishment and counter-establishment – to discuss the need and prospects for such an initiative, and how it might best proceed. In the world of human fallibility and imperfect understanding of the complexity of the economy, INET holds out the promise of the pursuit of alternative strands of thought – and thereby at least ameliorating this costly market imperfection.

1.2 STOCK MARKETS

Rebalance Your Asset Allocation

Asset allocation is like morality: it is most talked about and less practiced. Both have similar problems. On the face of it both are quite simple but the moment you try to implement, they become confusing. Like morality, asset allocation also is contextual and hence confusing.

Many people get tempted to deviate from it in search of instant gains and many times end up getting undesired results. If people start getting disciplined about their asset allocation and rebalancing, they are less likely to meet with financial disasters.

Get Priorities Right: Academic research papers have shown that asset allocation return contribute 90-95% of portfolio returns. Stock picking or fund manager selection does not contribute more than 10% of returns. The irony is that most of the investors spend 90% of the time on activities which contribute only 10% of returns. Thus asset allocation is extremely important and one should give enough attention to it.

Third Dimension: Many people are not aware that asset allocation is the three dimensional exercise. Most of us know of two dimensions – *risk* and *return*. In simple terms, if one is willing to take higher risk, then expected returns may be higher and vice versa. The third dimension of asset allocation is *correlation of assets with each other*. Blending of non-correlated assets improves risk adjusted returns. However, such correlation is not static. It keeps on evolving and hence asset allocation requires periodic monitoring.

Rebalancing: Rebalancing is a very important part of asset allocation. The asset allocation may get skewed due to movement of prices of various assets. It needs to be corrected and brought back to the model allocation for two reasons: The first is that a skewed portfolio may not help you achieve desired results in terms of risk and return. The second reason is that such rebalancing results in partial selling of assets whose prices have moved relatively higher and buying of assets whose prices have moved relatively lower. This becomes an automatic discipline and saves investors from bouts of fear and greed.

Deciding the frequency of rebalancing is also a challenge. Whether, one should do monthly, quarterly or yearly. Remember, too frequent rebalancing increase transaction cost and tax impact while too late rebalancing looses its purpose. One of the best solutions to decide an outer limit of tolerance and whenever it reaches that one can do rebalancing.

For example, if the model portfolio says 50% is equity and 50% in debt; one can set up limit or say 60-40, i.e., if equities rise and its allocation becomes 60% of the portfolio one can sell a portion and bring it back to 50% or vice versa. This will ensure that transaction costs are kept in check and transaction happens only when meaningful move in asset occur.

Asset allocation exercise is must for all savers. It inculcates discipline and discipline is the bridge between goals and accomplishment.

Right Asset Class for Investment

Stock market better option than gold & crude

In Bollywood film *Ghajini,* the lead actor suffers from a short-term memory loss. The current market euphoria reminds us a similar mental state of investors who are unable to grasp the hard lessons from the last year's global economic crisis. The crisis was predominantly about unsustainability of macro imbalances – imbalances within and between the nations as well as flaws in policies, regulatory structures and risk management practices that allowed these imbalances to take the world to the brink.

Many of these structural issues haven't been adequately addressed yet. In the midst of a very lukewarm recovery of a few economic indicators, the recent rally in almost all asset classes is baffling. The current market upswing is being driven by a huge surge in liquidity. This is driving the gold prices which are hitting record highs. Even oil and other commodity prices are showing a steady rise and the unprecedented liquidity is keeping the equity markets buoyant.

Confused investors are seeking answers and searching for appropriate asset class for investment. They are clinging on to gold. With looming inflation in the horizon we don't see any fault in this logic of buying or holding on to gold except the fact that the appreciation in gold may not be significant in the near term considering the fact that it is already at record high.

Oil as an investment avenue is a bit complicated and at present avoidable for general investors. Apart from demand/supply dynamics, geopolitical issues play a significant role in determining the price of oil. Subdued global economic activity will depress demand for oil and consequently its prices. Popular belief that holding oil as investment can act as a hedge against forthcoming increasing inflation will not hold true unless and until economic activity around the world significantly picks up.

Thus, in spite of nervousness around the world regarding a sharp rise in prices of equity shares over the last six months, investing in stock will continue to remain attractive. This is especially true in case of India. During the boom of 2007, the rate differential between the GDP growth of US, Western Europe and India was around 3-4%, as India was growing at around 8%, whereas these economies were growing at around 4-5%. Conservatively, India is expected to grow at around 6-7% during the next few years, whereas the US and Western Europe will either show de-growth or grow marginally. Thus the GDP rate differential has only moved up to 6%, making India more attractive as an investment destination.

India will continue to attract significant long-term FII fund inflows ensuring that there is an ample liquidity in the market. Domestic savings will also continue to get channelised indirectly through the mutual funds and insurance companies. The trick would be to identify the right sector and right company in these sectors. It is also very important to remember the cardinal principle of investment – *don't try to time the market, be in the market for a time*. Today's stock market levels are much closer to the 2007-08 peak than the bottom of 2008-09 and in the short-term market movements will be volatile and choppy. However, the medium-to long-term projection for Indian equity markets is very encouraging and investors with similar time horizon should definitely look at equity investments for building their wealth.

1st week of November 2009 – Sensex, Nifty bounce by 2% over the week

Buffett declares: Panic is over: Warren Buffett, at Columbia University's business school, said, "The financial panic that gripped the globe last year is a thing of the past, even as the US economy's struggles persist". His friend and fellow billionaire Microsoft co-founder Bill Gates said the economic problems of the past couple years proved that "we can make mistakes" but the fundamentals of America's capitalist system remain sound. The world's two richest men say capitalism is still alive and well despite lingering shocks from the longest, deepest recession since the Great Depression.

Daily review	30/10/09	02/11/09	**03/11/09**	**04/11/09**	05/11/09	06/11/09
Sensex	15,896.28		**(491.34)**	**507.19**	151.77	94.38
Nifty	4,711.70		**(147.80)**	**146.90**	54.75	30.60

Tuesday (03/11/09): Indian equity benchmarks fell for the sixth straight session on Tuesday as the Australian central bank confirmed the beginning of a tighter monetary regime, by raising interest rates.

Wednesday (04/11/09): The dramatic bounce came after a two-week slide which took the Sensex to a 10-week intra-day low of 15,330.36 on November 3, as the government rushed to the rescue of market, putting at rest speculation about withdrawal of financial packages. Planning Commission also pitched for aggressive disinvestment, and said the proceeds should be utilised for new investment projects.

Weekly review	30/10/09	06/11/09	Points	%
Sensex	15,896.28	16158.28	262.00	1.65%
Nifty	4,711.70	4,796.15	84.45	1.79%

2nd week of November 2009 – Sensex, Nifty bounce by 4% over the week

FII shopping binge at $15 billion: Net purchases of Indian shares by FIIs have topped the $15-billion mark for the current calendar, and the market watchers say a depreciating dollar could drive more money into emerging markets like India in the near term. India has also been a beneficiary of the asset de-allocation that is happening globally. In other words, dollar carry trade with risk assets has been seeking more attractive investment destinations, mainly in emerging markets.

Peter Elston, strategist, at the Singapore based Aberdeen AMC says, "There is strong demand for emerging equities by various investor groups. In the absence of any external shock we can see this continue for the time being. Flows will continue to be positive. However the Indian market is starting to look fairly valued and one cannot expect to see returns that we witnessed for the last six months to continue. In the long term, we might see some hard wind."

Daily review	06/11/09	09/11/09	10/11/09	11/11/09	12/11/09	13/11/09
Sensex	16158.28	340.44	(58.16)	409.04	(153.57)	152.80
Nifty	4,796.15	102.25	(16.70)	122.25	(51.30)	46.30

Weekly review	06/11/09	13/11/09	Points	%
Sensex	16158.28	16,848.83	690.55	4.27%
Nifty	4,796.15	4,998.95	202.80	4.23%

Weekly review: The global factors that helped Indian bourses rise near to 6% in November so far may continue to power a short-term bull run next week as investors turn to risky-assets following sliding dollar against a basket of currencies. Analysts credited sustained rally from the intra-day low of 15,330.56 on November 3, first trading day of the month, to a high of 16,904.74 on November 13, to dollar's fall to a 15-month low during the week under review.

3rd week of November 2009 – Sensex regains 17K level on ample liquidity

Daily review	13/11/09	16/11/09	17/11/09	18/11/09	19/11/09	20/11/09
Sensex	16,848.83	183.68	18.14	(51.87)	(213.13)	236.20
Nifty	4,998.95	59.10	4.20	(7.55)	(65.70)	63.45

Weekly review	13/11/09	20/11/09	Points	%
Sensex	16,848.83	17,021.85	173.02	1.03%
Nifty	4,998.95	5,052.45	53.50	1.07%

Weekly review: Indian bourses ended well past the 17k psychologically important level over the week as positive liquidity situation and a strong build-up in the derivatives series indicating bullish trend in short term. The market is expected to draw support from a gradual recovery in the economy with simultaneous growth in India's industrial production in the few months. The BSE barometer gained 1,126 points or 7.0% in the three weeks. The business confidence in India also witnessed a sharp rise from that of during the financial crisis a year ago.

4th week of November 2009 – Dubai debt crisis – Sensex down by 2.29%

Daily review	20/11/09	23/11/09	24/11/09	25/11/09	**26/11/09**	**27/11/09**
Sensex	17,021.85	158.33	(49.10)	67.87	**(344.02)**	**(222.92)**
Nifty	5,052.45	51.10	(13.00)	17.60	**(102.60)**	**(63.80)**

*Thursday (26/11/09): **Dubai shakes global scrips**: Debt problems in Dubai hit global stocks. Dubai said on Wednesday it was asking creditors of Dubai World and property group Nakheel to agree a debt standstill as it restructure Dubai World, the conglomerate that spearheaded the emirate's breakneck growth. The announcement triggered widespread concern about the once-booming Gulf region's financial health, although some investors differentiated between leveraged Dubai and other more solidly wealthy emirates and countries in the region. But the worries added to general nervousness in financial markets about the real state of the world economy at a time when investors are also seeking to lock in 2009 profits. The Dubai story is weighing heavily on stock markets and people are looking to safe havens so there's some flight to quality again.*

Weekly review	20/11/09	27/11/09	Points	%
Sensex	17,021.85	16,632.01	(389.84)	(2.29%)
Nifty	5,052.45	4,941.75	(110.70)	(2.19%)

Dubai impact likely to be limited: On Friday, the Sensex fell 223 points, or 1.3%, joining global markets in a repeat of Thursday's fall, following reports of a possible debt default by state-controlled Dubai World. The development reinforces two key lessons of the financial crisis: one, despite India's limited financial opening, volatile capital flows can be disruptive; two, excessive borrowing, whether by a company or a country – remember Iceland and before that Argentina in 2001 – is dangerous.

On the face of it, the problem at Dubai World, a conglomerate with interests across real estate, ports and the leisure industry, should not affect us much. The RBI has asked all banks to report their exposure to the troubled region, but does not see much cause for alarm. Thanks to conservative regulation by the RBI, Indian banks are unlikely to have much exposure to the beleaguered giant. With west Asia ceasing to be the main source of remittances for India, these flows might not suffer either.

Nonetheless, as markets across the world tanked, it is clear that the panic and resultant flight to less-risky assets will take its toll of our markets too. If attempts at restructuring outstanding bonds, including that of troubled property unit Nakheel, that has to repay $4 billion on December 14 do not succeed, it could call into question the emirate's ability to deal with the $80 billion owed by the government and state-controlled companies. Abu Dhabi, the major creditor, might yet restructure debt, after extracting its pound of flesh from its more flashy and adventurous neighbour.

Credit default swaps on Dubai's sovereign debt have shot up to levels higher than Iceland's, as have spreads of other emerging market debt. This could rub off on Indian companies trying to roll external loans over or launch initial public offer.

Last day of November 2009 –

Daily review	27/11/09	30/11/09
Sensex	16,632.01	16,926.22
Nifty	4,941.75	5,032.70

Weekly review	27/11/09	30/11/09	Points	%
Sensex	16,632.01	16,926.22	294.61	1.77%
Nifty	4,941.75	5,032.70	90.95	1.84%

6-Monthly Review

Monthly Review

Month	Dec '07	June '08	Dec '09	June '09	Sep '09	Oct '09	Nov '09
Date	28/12/07	30.06.08	31/12/08	30/06/09	30/09/09	31/10/09	30/11/09
Sensex	20,206.95	13,461.60	9,647.31	14,493.84	17,134.55	15,896.28	16,926.22
Points	Base	(6,745.35)	(3,914.29)	4,864.53	2,640.71	(1,238.27)	1,029.94
%	Base	(33.38%)	(28.33%)	50.24%	18.22%	(7.23%)	6.48%

Déjà Vu? NSE Curve Points to Better Times

History, it seems, is repeating itself. The movement of the NSE Nifty in 2009 has resemblance to the technical trends of 1999, and if the same logic holds true, the Nifty could well touch its all-time high in the next two months, a joint study reveals. The study compares all four phases of market trends and the underlying economic conditions a year ago. The similarities do not end there. Both the rallies of 2009 and 1999 came after a severe financial crisis.

Analysis of the movement of the Nifty during 1999 and 2009 shows that there were two upward rallies and two small declines between April and November in both the years.

The first upward rally in 1999 was between April 1 and May 19, when the Nifty went up by around 11%. In the second phase, between May 19 and May 28, it declines by around 8%. After this small decline the bulls pulled the index up by around 39% in the next upward rally that took place between May 28 and October 14. After every top, bottom are formed and so in the next phase bears outpaced bulls and the Nifty declined by 17% between October 14 and November 1.

Similarly, in this year the Nifty formed four main phases. The period between April 1 and May 20 can be termed as first phase when the Nifty appreciated by 40%. In the second phase – May 20 and July 13 – it declined by 7%. Again the bulls triggered a 29% rally in the third phase, which took place between July 13 and October 17. Similar to the trend in 1999, in the fourth phase between October 17 to November 3 this year the Nifty dipped by 11%.

After the decline in the fourth phase in 1999, the Nifty appreciated by 38% in the next two months. And if it isn't a mere coincidence but a rational reaction of investors in a given market condition, the equity markets are going to go up in the next couple of months.

It's not just the numbers. There are other similarities in economic conditions: in 1997-1998. The global financial market crisis started with the collapse of the Thai Baht in July 1997 and continued with the Russian financial crisis of August 1998. Finally the crisis culminated with the collapse of Long Term Capital Management (LTCM) in September 1998.

Similarly, during this 2007-08 crisis, it started with sub prime crisis in April 2007 when New Century Financial, which was the second largest originator of sub-prime mortgages in the US, filed for bankruptcy. The crisis continued with Bear Sterns requiring emergency funding and later being acquired by JP Morgan during March 2008. The crisis did not end here. Lehman Brothers filed for bankruptcy on September 15, 2008.

Not just QIPs,
Preferential Shares too fetch big bucks

In addition to Qualified Institutional Placements (QIPs) and public debt mobilisation, companies have also used the preferential allotment route to raise working capital. Easier norms and availability of low-cost funding are said to be the main reason for institutional buyers to participate in preferential allotment by companies. Promoters are also using this route to increase their shareholding in the company.

According to Prime Database, companies have mobilised over Rs 7,700 crore through preferential allotment of equity shares between January and October 2009. Though this number is significantly lower when compared to preferential issues made in 2006 (Rs 14,164 crore), 2007 (Rs 27,082 crore) and 2008 (Rs 41,673 crore), net mobilisation through preferential issue could cross Rs 10,000 crore by year end.

The dip in number of preferential allotments is attributed to large number of QIPs hitting the market over the past 6-months. About 40 issues have collected Rs 28,434 crore during the period (till October 2009). QIPs, for sure is an easy way to raise money (or make investments, from the point of view of an institutional investor) as it does not have a lock-in-period. Under QIPs, the investor can sell his entire holding the moment he sees profit.

An investor into preferential allotment needs to mandatorily lock in his investment for one year. The lock-in, however, will not deter institutions from investing through the preferential route. The segment will heat up further once private investment in public equity (PIPE) deals start happening in the market. Amongst companies that have raised money (as per MSE data) through preferential issue of equity shares are Axis Bank (Rs 360.56 crore), ING Vysa Bank (Rs 186 crore), J Kumar Infra (Rs 24 crore), Delta Corp (Rs 60 crore), Simbhaoli Sugar (Rs 273 crore) and Jai Balaji (Rs 273 crore).

Long-term institutional investors (like PE funds) prefer preferential route as it helps them have management control in the company. A reasonably well-priced preferential issue will find takers in this market. Every promoter aspires to have long-term investors in their companies. More-over, you get an investor of your choice through preferential allotments.

As per Sebi guidelines, the placement price should not be lower than the following: average weekly high and low closing prices of the last two weeks or the average of the weekly highs and lows of the closing prices during the past six months.

While the main idea of a preferential allotment is to raise working capital, promoters also use this route to consolidate their holdings in the company, by issuing shares warrants to themselves. Promoters who are hopeful of their business over the medium-term use the preferential allotment route to increase holdings in the company. And when other institutions pick up preferential shares, this also adds to the confidence factor. Moreover promoters and institutions have access to information (those are not available to lay investors). Their decisions are well thought of. This can be used to make gains.

2.1 INDIAN ECONOMY

Unlike China, India Grows with Values: PM

In an unusually biting comment on Communist China, Prime Minister Manmohan Singh said that the India growth model was better suited than Beijing's as it places premium on democratic values.

Addressing the strategic affairs community at the US Council for Foreign Relations in Washington, the Prime Minister pointed out that China's growth had been achieved by the "writ of the ruling group in an undemocratic set-up" while "ignoring values like respect for human rights and multi-ethnic and multi-cultural rights." Prime Minister acknowledged that China's growth performance was superior to India, but said he would stick to the Indian path and day.

Dr Singh said during an interaction at the influential think-tank that no doubt Chinese growth performance was superior to India's growth performance. But I always believe that there are other values which are important than the growth of GDP – respect for fundamental human rights, respect for rule of law, respect for multi-cultural, multi-ethnic, multi-religious rights." China's growth rate at 9% in 2008 and 7.7% in the first nine months of the current fiscal has dazzled the world. However, Mr Singh injecting a dose of realism was critical of the way China has achieved this growth rate. "There are several dimensions to human freedom which are not always caught by the numbers with regard to the GDP. So, I do believe that even though Indian performance with regard to GDP might not be as good as the China, certainly I would not like to choose the Chinese path. I would like to stick to Indian path."

He admitted India might seem indecisive at times, but maintained that "once democracy decides on the basis of wide-ranging consensus, any reforms that are undertaken will be far more durable, far more effective than the reforms introduced by the writ of ruling group in a non-democratic set-up.

Mr Singh said during an interaction at the US Council for Foreign Relations in Washington that he was puzzled by the recent show of Chinese assertiveness. "There is certain amount of assertiveness on the part of Chinese. I don't fully understand the reasons for it. That has to be taken note of,"

Though the Indian government has continued to say that there is enough space for both India and China to grow in the region, Mr Singh's comments mirror the unease in New Delhi with Beijing as it becomes more vocal on global and regional issues.

Mr Singh's reference to the undemocratic set also comes in the backdrop of the recent engagement between US and China. A joint statement released after discussion between US President Barack Obama and Chinese president Hu Jintao not only pointed to a bid by Beijing to increase its influence in South Asia but also the new dynamics between US and China. China has also become increasingly vocal on the border issue protesting against Mr Singh's visit to Arunachal Pradesh and then later the Dalai Lama's.

Further Beijing has also been steadily increasing presence in the region and is helping Pakistan with developmental projects in Pakistan occupied Kashmir. The continued insistence by Beijing on issuing stapled visas to Kashmiris traveling to China has also annoyed New Delhi which had to stop the practice by refusing to recognise staples vises as an authentic travel document.

Referring to the longstanding India-China border problems, the Prime Minister said India has been "trying hard" to engage China over the last five years in a bid to resolve the dispute through dialogue and that he had received assurances from China at the highest level."

2.2 INDIA

Reverse Innovation

The Innovative Revolution: Innovation and creativity are new intangibles. With the 21st century being aptly described as the new age of innovation, these new intangibles need to be suitably factored. In the Indian context, the dawn of this new age of innovation can be traced to the budget speech of July 24, 1991 by the then finance minister (current prime minister) Dr Manmohan Singh, when he said that "*no power on earth can stop an idea whose time has come*". There has been a redefinition of economic ideology at country level thereafter. And there has been a considerable rise in valuations of India at the macro level. India is now being reckoned as a major "economic power" of the current century.

The rise of Indian IT sector bears testimony to the role played by ideas and creativity, providing solutions for many complex problems of developed western economies. This has been responsible for transforming the traditional image of India from being a land of elephants and snake charmers to its present status of a technology power. Giving encouragements to innovation and creativity would also facilitate finding alternate mechanisms for channelising the creative energies of India's relatively younger, educated and rapidly growing workforce even as the west, China and Japan have ageing demographics.

In a recent article in the *Harvard Business Review*, Jeffrey Immelt, CEO of General Electric Co stated that GE and other US-based multinational companies will see their growth depend on "*reverse innovation*" or *developing products in emerging countries such as China and India*. There is an acceptance in the west of a new trend that would see emerging economies such as India and China become new factories of mass production of creative ideas. This would be in sharp contrast to the present economic model under which lower-end jobs are outsourced to emerging economies for labour arbitrage.

Among various emerging mass-idea factories, India has a greater potential to be a leader during the next decade or so, thanks to its relatively younger, educated workforce with strong analytical skills. Emerging fields such as logistics, engineering design and implementation, polymer and thermo-plastics, space research, molecular biology, synthetic chemistry, bio-technology, genomics, bio-informatics, DNA technologies, pharmaceuticals, entertainment, gaming, animation, education, publishing, hospitality, healthcare and agri-farming offer potential for a diverse field of activities with unexplored opportunities.

To draw true benefit of the wisdom of many, due consideration needs to be given for leveraging mass collaboration to achieve business goals similar to *the concept of crowdsourcing* defined by Jeff Howe in June 2006. Encouraging innovations, brainstorming and questions and answers through crowdsourcing can be an answer to corporations looking for innovative solutions by combining the wisdom of many individuals or community groups using online medium as is being done by Wikipedia, Linex, and others.

Historical valuations of countries of the European and American continent, which had risen after the new discoveries in science and technology, particularly during the period of Industrial Revolution of the 19th and 20th century and the information technology revolution of the last quarter of the 20th century, is now giving way to the innovation revolution led by India and China.

An example of the emergence of this trend is seen in the job market, coming full circle from a period before the Industrial Revolution when China and India were the richest countries and did the best quality work to a period during Industrial Revolution when these jobs moved to western countries, and now back again to China and India in the form of outsourcing of innovative low-cost creative solutions in manufacturing and services sectors.

2.4 INDIA INC

Industry Suggests New Measures to Boost Innovation

India has some great examples of innovation – Tata Nano, Amul, and sub-Rs 1,000 mobile phone – yet it ranks a lowly 41 in the global innovation index. This could change dramatically as business leaders in India see the country emerge as an innovation hub in areas spanning information, communication, telecom, financial products, agriculture, biotechnology and green technologies. Industry can also innovate in niche areas like climate-friendly technologies, where the market will not only be local but global.

In an All India Management Association (AIMA)-Accenture research report, 50 business leaders from companies like Tata Motors, Microsoft, Cisco, Marico, Yes Bank and 200 consumers have identified these areas for innovation and called for better infrastructure (in terms of finance and mentoring) to catalyse innovation. This is the first-of-its-kind survey on innovation being done in India and follows the government's thrust on innovation. Apart from identifying areas for innovation, the report emphasises that businesses should capitalise on the large pool of workforce in the country (27.6% of the population) in the 18-64 year age group involved in entrepreneurial activity. While the opportunity to innovate is great, there are quite a few hurdles. These include lack of risk capital, mentoring and few technology labs.

Sam Pitroda, Prime Minister's advisor on innovation etc said, "India has the potential to innovate at all levels. Successes in IT-Telecom can be used to innovate in areas like health, education, public services and social sectors. Web and mobility have transformed the world and these could be used for innovation.

R Gopalakrishnan, executive director, Tata Sons said innovation requires 4Cs: Chaos, Creativity, Communication and Channelisation. "India has three of the 4Cs needed for innovation. We have to work on the last C to make India the world capital for value innovation." That relates to creating proper channels to work on ideas that the market needs and then taking these to the people.

For instance, M&M is working on a low-cost tractor considering that India farm sizes are small. Godrej is working on a low-cost fridge 'Chotukool' priced between Rs 3,250 to Rs 3,750. Tata Group developed a low-cost super computer called Eka with a peak performance of 165 Teraflops of computations per second. It's used by TCS, Tata Motors, Tata Elexi and other companies. Such innovations augur well for the future, yet lots of innovations don't go beyond concept stage. RA Mashelkar, chairman, National Innovation Foundation said, "Our problem has been moving from mind to market. VC funds are available but not quite like adventure capital or risk capital. Risk financing has to improve which will encourage innovations. The AIMA-Accenture report identifies the right issues. Now the document needs to be enhanced to show the way for large-scale innovation activity that can find its way to the market."

Bajaj to use bike, 3-wheeler parts in $2,500 car

No Greenfield Plant; Move to cut capex from Rs 1500 cr to Rs 300 cr

A JV between Renault-Nissan and Bajaj Auto, which plans to launch a low-cost car to compete with the Tata Nano, will have 70-80% of its part in common with those used in the scooter, motorcycles and three-wheelers. In May 2008, Bajaj, Nissan and Renault had announced plans to manufacture 4 lakh ultra low cost (ULC) cars per year at a new plant that would have cost Rs 1500 crore. Nearly all aspects of that earlier agreement have now changed. Bajaj Auto MD Rajiv Bajaj said, "I don't have a number as yet but my estimate is that cost of the project would be closer to around 20% of the earlier investment figure." There is excess capacity in the global car market. Our thinking was that if the ULC is a stand-alone project, it will be vulnerable to business cycles. We decided to de-risk the project by leaning on our motorcycle and three-wheeler for its platform and aggregates.

2.3 INDIAN

Generation I

India is impatient, and rightly so. In the past two decades, the speed of India's economic and social progress has been impressive. From an economic standpoint, the 1991 reforms spearheaded by then finance minister and now Prime Minister Manmohan Singh not only changed the competitive landscape within India but also changed the mindsets in business, government and civil society. GDP grew at over 6% per year between 1991 and 2008. Today, India is one of the fastest-growing economies in the world.

But the most impatient for change are the people who take that growth for granted – 'Generation-I' – the young Indians born between 1984 and 1991. They are today's 18-25 year olds. They have grown up in an India hugely different from that of their parents and grandparents. The planned economy, state intervention and the infamous 'license raj' are a lost world. Generation I's India is driven on entrepreneurship, creativity and innovation.

And Generation I's India is no longer insular and insecure – it can speak to the world. In Generation I's lifetime, India joined the *World Trade Organisation*. It boasts world-class business process outsourcing, providing almost three quarters of the Fortune 500 and half of the Fortune 2000 companies with technology related services. They've grown up to expect Indian companies to be confident players in world economy, watching them acquire international industry icons like Jaguar and Corus.

And, that the same Generation I has confidence in its ability to communicate. Its India is now the world's second largest mobile phone market, with a billion subscribers projected by 2013. At the national elections earlier this year, Generation I accounted for nearly 100 million of the nation's eligible voters and political parties adapted their campaign strategies making use of internet and SMS to reach out to them.

It is exactly in the lifetime of this young India that the *World Economic Forum* marked a seminal point in its own history with India. This began in 1984 with an invitation of late PM Rajiv Gandhi, who encouraged the Forum to treat a platform with which we could show the world that the country was ready to come out of years of isolation and move toward a trajectory of modernisation and inclusive growth.

In the past 25 years, the India Economic Summit of World Economic Forum has became the place for continuous interaction with peers and with the most knowledgeable people in the field to deliberate challenges to India's future growth and to formulate recommendations to address these with a multistakeholder approach.

India's young and eager population has set the bar even higher for further action and will expect implementation of solutions with the same tempo which has characterised the past two decades of India's growth. Next to its strong economic fundamentals, India's youthful population calls attention to a demographic dividend which could see India become a hub for manufacturing and technological innovations amongst other things provided salient issues such as skills development are addressed.

India's young generation has grown up in a context where untapped potential is being transformed into a plethora of possibilities. Their India has moved from a gentle gait to a gregarious gallop. But, the promise of further progress stimulates a voracious appetite and young India is hungering for more.

Within five years, more than half of India's total population is estimated to be under the age of 25. To keep India on a path of sustained economic growth, numerous economic and social challenges must be addressed to ensure its momentum will persist and its outcome will be inclusive in the years to come.

2.5 INTERNATIONAL

1. China economic recovery accelerates

Chinese factory output growth surged to a 19-month high in October, showing the world's third-largest economy has firmly put the worst of the global financial crisis behind it. Industrial output rose 16.1% in the year to October, the fastest pace since March 2008. The figure, up from September's reading of 13.9%, easily beat market forecast of 15.5% growth.

Other figures showed a dip in the pace of **investment and loan growth** as the impact of the initial burst from a bank-financed 4 trillion yuan ($585 billion) economic stimulus package, announced a year ago, tapered off. Policy makers have asked banks to lend less freely. Gao Shanwen chief economist at Essence Securities in Beijing said, "There will be no immediate policy shift, but a tightening policy is the big trend as the economy is growing so fast."

Exports and imports also undershot market forecasts, falling from year-earlier levels for the 12th month in a row. Exports in October were down 13.8% from a year earlier, an improvement on September's 15.2% fall. And imports were down 6.4% from October 2008, compared with a 3.5% y-o-y decline in September. As a result, the October trade surplus balanced to $24 billion.

Domestic demand as a whole is improving in a sustainable manner, said Chris Leung, economist at DBS Bank in Hong Kong. China anchors stability in Asia and expectations of economic stability in the region.

Deflation eased in October, but not by as much as expected. Consumer prices fell 0.5% in the year to October, with producer prices down 5.8%.

Economists said China is maintaining the momentum of its recent recovery, which has made it a certainty that Beijing will surpass its target of 8% growth for 2009 as a whole. What's more, the large number of investment projects still in the government's pipeline, a sharp rebound in real estate spending and a huge volume of loans issued this year virtually guarantee stronger GDP growth in the coming year.

2. Eurozone emerges out from recession grip

The 16-country Eurozone has officially joined the US and Japan out of recession, after figures on 13/11/09 (Friday) showed its economy grew by 0.4% in the 3rd quarter from the previous 3-month period. However, the rise reported by EU's statistics office Eurostat was not as large as the 0.6% most economists had been predicting, as growth in major economies fell short of forecasts. With a rebound in exports partially offset by weak household spending, Germany's economy grew by 0.7% and France by 0.3%.

Still the third quarter rise in Eurozone output was the first in six quarters and brings to an end Europe's sharpest recession since World War II. Though the Eurozone's banks were not at the epicentre of the financial crisis, the region suffered as demand for its high-value products fell off a cliff. The recession was particularly savage at the turn of the year.

The 1.8% quarterly decline recorded in the fourth quarter of 2008 was followed by an even bigger 2.5% drop in the first quarter of 2009. In the second quarter this year, output fell a modest 0.2% as Germany and France emerged from recession.

The scale of the downturn in the Eurozone is more visible in the annual comparisons. Although Eurozone output grew on a quarterly basis, it was 4.1% below year-ago levels in the third quarter, a modest improvement on the 4.8% slide recorded in the previous three months.

Despite the modest improvement, growth is not expected to return to pre-crisis levels for a while yet, meaning the output lost during the recession will take years to be made up. The IMF has warned that recovery will be anaemic if policymakers don't do more to sort out problems in the financial sector and as long as rising unemployment keeps consumer confidence down – in Spain, the jobless rate stands at an astonishing 19.3%.

Jonathan Loynes, chief European economist at Capital Economics said, "The region is at least out of recession and still on track to grow by a reasonably solid 1.5% odd next year, but there is scant evidence yet of the pickup in domestic demand needed to sustain a stronger recovery."

The US also returned to growth in the third quarter, growing by a quarterly rate of 0.9%, according to Eurostat while Japan's recession ended in the second quarter when its economy grew by 0.2%.

3. **it's a bumpy road to US recovery**

The US economy grew more slowly than initially thought in the third quarter, held back by strong imports and weak investment in non-residential structure, hinting at a lacklustre recovery.

Corporate profits surged, however, as businesses managed to ramp up output even as they were still cutting payrolls. In the second reading of third-quarter gross domestic product, the Commerce Department said the economy grew at a 2.8% annual rate, rather than the 3.5% pace it estimated last month. However, it was still the fastest pace since the third quarter of 2007. GDP measures total goods and services output within US borders. Julia Coronado, senior US economist at BNP Paribas in New York said, "This demonstrates that the rebound was a little bit more subdued than the first print had suggested and highlights some of the headwinds to growth that could continue."

Surging imports, which outpaced the growth in exports, restrained the economic growth rate in the third quarter. Imports jumped 20.8%, the biggest gain since the second quarter of 1985, instead of 16.4%. They knocked 2.53 percentage points off real GDP, the department said.

Another drag on GDP came from the construction of non-residential structures, which dropped 15.1% in the past quarter rather than 9.0% highlighting the problems in the commercial property market. That shaved just over half a percentage point off GDP.

Businesses reduced accumulated unsold goods in the past quarter at a slightly faster rate than had been anticipated. Business inventories fell $133.4 billion rather than $130.8 billion the government estimated in October. The decline was still a slowdown from the record $160.2 billion plunge in the second quarter. The change in inventories added 0.87 percentage points to real GDP in the third quarter.

The slide in inventories is potentially a positive development as it suggests businesses may be getting closer to a point where they will stop clearing their warehouses of unsold goods and start placing new orders. That sets up for a better fourth-quarter GDP with more restocking.

2.6 WARNING SIGNALS

IMF Warns G20 for Cutting Economic Support Too Fast

ST ANDREWS, Scotland November 6 2009 (Friday) – IMF warned global financial leaders not to repeat the mistakes of the Great Depression and choke off emergency support for their economies too quickly. In a document prepared for a meeting of Group of 20 finance ministers and central bankers in Scotland, the IMF stressed the fragility of global recovery, saying it was largely dependent on government and central bank support. The IMF paper said, "One of the key lessons from the experience of similar crises (such as the Great Depression and Japan in the 1990s) is that withdrawing policy stimulus too early can be very costly, particularly if the financial system remains vulnerable and prone to adverse shocks".

G20 meeting host and British finance minister Alistair Darling is hosting the 3rd meeting of G20 finance ministers and central bankers this year in Scotland, aiming to put flesh on the bones of agreements made at a leaders' summit in Pittsburgh in September. He said, "Policymakers would maintain their pledge to keep support in place until recovery was assured and also launch a new system of mutual checks to help rebalance world growth and prevent future crises. I think we can reach agreement on making sure that we don't remove support too early because the recovery is by no means established everywhere".

Ten years after the G20 was formed, leaders agreed in Pittsburgh that it should be the world's main economic governing council, because it also includes most of the key developing economies. The proposals on the table in Scotland include a system where countries put forward projections for their own economies for examination by the IMF to see if they are consistent with each other. If not, then alternatives can be looked at within the G20. The group may also look at proposals for creating a common pool of reserves to dissuade emerging market countries from accumulating massive foreign exchange reserves that could instead be used to boost growth.

G-20 launches framework to boost global economy: The finance ministers of G-20 nations have agreed on a timetable for the new framework for balanced and sustainable growth of the global economy. They committed to have peer review and "more specific policy recommendations" in place by next November. They hoped that if all countries put political weight behind the negotiations over the next year, the world can recover without developing the huge trade and financial imbalances of the past decade. But there was no agreement on a specific set of common objectives, not a mechanism to resolve disputes. On the climate change, the finance ministers agreed only to keep working for an ambitious outcome at next month's meeting in Copenhagen but could not agree on the amount of money developed countries will offer to poorer countries to help them reduce their carbon dioxide emissions.

The meeting was also overshadowed by a dispute about the possibility of a global tax on financial transactions. Addressing the meeting, British Prime Minister Gordon Brown floated the idea of such a tax would help banks to pay for the insurance they receive from taxpayers. Within hours of the suggestion, the idea appeared still-born when US Treasury Secretary Tim Geithner told Sky News: "A day-to-day financial transaction tax is not something we are prepared to support." But some of the other measures mentioned by Brown – an insurance fee to reflect the risk of some banks, a pre-funded pool of money to support orderly bank bankruptcies and contingent capital arrangements – have more international support. The US is supportive of efforts to ensure banks cannot rely on taxpayers to bail them out in future.

Richard Dixon, the Director of WWF Scotland said: "The G20 Finance Minister meeting turned out to be a mostly irrelevant sideshow on the way to the talks in Copenhagen in a month's time. Failure to come to agreement is a major disappointment." Given that these are the people who run the biggest economies in the world it seems unlikely that they will manage to devote any serious time to the issue of climate finance before the start of the Copenhagen meeting.

3.1 MUTUAL FUND

1. Value Averaging Investment (VAI)

A new investment theory is gaining favour with wealth managers and mutual funds; something that could soon replace the conventional systematic plans (SIPs) strategy. This technique allows investors to determine the size of investment needed (at a time of investment) to get desired returns. Value averaging works much like rupee cost averaging, which forms the basis of systematic investment plans.

While SIP investments are made on fixed dates, irrespective of market conditions, VA investments are made on dates when the markets look investible. The best aspect of VIA is that it enables investors to buy stocks at dips – a facility that is not really possible in SIPs. In value averaging, the investor sets a target growth rate or amount for his portfolio each month, and then adjusts the next month's contribution, according to the relative gain or shortfall made on the original asset base.

To cite an example, investor A needs to invest Rs 1,000 (calculated using statistical formulae) every month to get 15% return (on his investments) over a time-frame of 10 years. A invests Rs 1,000 in the beginning of the month (usually when the market is trading lower). At the end of the first month A's investment has declined to Rs 800 as a result of the further fall in market. To correct the course to target growth rate, A invests Rs 1,200, making net term investment to Rs 2,000.

Conversely, had the markets gained and A's investment surged in value by Rs 200 (taking the total value to Rs 1,200 at the end of the first month), he would only have to pay Rs 800 in the second month. So under VAI, investors contribute to their portfolios in such a way that the portfolio balance increases by an amount calculated by a formula-based technique, regardless of market fluctuations. As a result, when the market declines, the investor contributes more and when the market goes up, the investor contributes less.

Though VAI has no historical reference, returns (asset growth) could well be very close (or, a bit high) to those offered by investments through SIPs. One negative aspect to VAI is the fact that the investor's asset base grows, shortfalls (in case of market slumps) become too large to replace (especially for retail investors). While several fund houses are planning to introduce VAI plans on existing MF schemes, the Benchmark Mutual Fund has attached value averaging transfer plan (VTP) in its derivative fund, equity fund and derivatives opportunities fund.

2. Buy & Sell MF Units at the Click of a Button

SEBI chairman CB Bhave, who played a key role in revolutionising stock trading in the country more than a decade ago as the head of National Securities Depository (NSDL) may be about to trigger another big-bang change. This time, in mutual fund (MF) investing; come March, investors can directly buy or redeem units at the click of a button, bypassing intermediaries.

The National Stock Exchange (NSE), which pioneered electronic trading in India and NSDL, will together develop a trading platform where MF units can be bought or sold without an intermediary. To avoid a monopoly, the Amfi has also chosen Central Depository Services, a BSE sibling and registrars CAMS-Karvy to develop a similar platform. Both these fund exchanges may begin trading by March. The proposed structure will be something like share trading on portals such as sharekhan.com or icicidirect.com where investors buy or sell shares without even talking to their brokers. The shares are either credited or debited at the depository account with either NSDL or CDSL.

3.2 THE GREENBACK WORRIES

No $ Panic Yet: The death knell for the dollar has been sounded many a time in recent years, but its weakness has still not alarmed investors. Low interest rates in US have contributed to the dollar's weakness in recent months as investors use it as a funding currency in carry trades, in which traders borrow in low-yielding currencies and invest in assets with greater returns.

The Fed kept interest rates at near zero, and expects to maintain that for "an extended period". Questions now focus on how much further the dollar can fall before investors flee US assets. Analysts believe that spike in volatility due to bad news could heighten foreigners' concern about US assets. However, robust equity markets and steady appetite for US Treasuries suggest investors still have faith in US assets. For now, a weak dollar is viewed as desirable for boosting exports for the ailing US economy, even though the Obama administration, like those before it, stresses its preference for a strong dollar.

The dollar has declined 15% against a basket of six major currencies from the highs set in March and is down more than 37% from a peak in 2001. Alan Ruskin, global head of currency strategy at RBS in Stamford, Connecticut, said, "The market appears to be taking the appropriate view that we are sucking the last juice out of the short dollar trade." However, some economists caution that a weak dollar risks a flight out of US assets, leading to a damaging spike in US rates. This fear has been stated previously, but the US, due to its size and role as the world's reserve currency, has a natural buffer that separates it from Iceland or Hungary, smaller economies that have suffered from the swift exodus of capital.

Playing Safe, **India, China cut US debt holdings**

The two fastest-growing economies in the world – India and China – are easing up on their investments in US treasuries bonds since June this year. According to the latest data released by the US treasury, India has reduced its exposure to US treasury bonds by close to 8% between June-September 2009 to $ 35.9 billion. China, the biggest investor in US treasuries at close to $ 800 billion, has also slowed down its pace of investment in US gilts. Between September 2008 and March 2009, it pumped in almost $ 150 billion in US treasuries. But since April, it has invested just about $30 billion.

Significantly, India and China have started going slow on US treasuries at a time when both the countries are witnessing a sharp rise in capital inflows. Besides India and China, even oil exporters comprising Ecuador, Venezuela, Indonesia, Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates, Algeria, Gabon, Libya, and Nigeria and Carribean banking centres, which have an exposure of over $ 150 billion each in US treasury bonds have also slowed down their investment.

Dollar still the 'currency of choice' for carry trade

The US dollar is expected to retain the carry trade currency of choice in the near term and unwinding of this carry trade in unlikely to be as severe as that of the yen carry trade seen in the early 2008. Hemant Mishr, MD, head-global markets, South Asia, Standard Chartered Bank said, "The dollar carry trade is yet to play itself completely out. Given the nascent economic recovery in the US, monetary policy is expected to remain easy over the foreseeable future thereby fuelling interest in the dollar for carry purposes".

Yet strategists believe the timing of this unwinding is the critical question. Typically, while unwinding, investors will look to exit their risky assets and buy back the dollars which they have borrowed. In the process, the dollar may rally significantly. Everyone thinks it is a one-way bet and it has become a crowded trade. Strategists maintain that there are signs that the carry trade is under pressure and investors should be careful in assuming that dollar weakness is a given, as this could easily reverse.

3.3 GOLD AT $1,100

Gold surges to record level

Gold surged to a record high above $1,100 an ounce, up more than 25 % this year, on November 6 (Friday) as investors sought safety after data showed the US unemployment rate unexpectedly jumped to 10.2% in October. US employer cut 1.9 lakh jobs in October, greater than the 175,000 fewer jobs forecast, and the unemployment rate rose to 10.2%, a 26-1/2-year high that was above average forecast of a 9.9 %.

Frank McGhee, head precious metals trader at Integrated Brokerage Services in Chicago said, "Gold rallied early on the unemployment numbers being higher than expected. It fuelled thoughts of additional stimulus and reinforced the concept that the Fed will not be able to raise rates any time soon."

RBS metal analyst Stephen Briggs said, "The market has the bit between their teeth – all these investors have piled into gold in a quasi-physical sense and now they are being supported in that by the actions of Mr Central Bank." Michael Lewis, head for commodities research at Deutsche Bank said, "The trigger for the surge was news that the IMF had sold 200 tonnes of gold to the Reserve Bank of India for $ 6.7 billion. People are focusing on pent up demand for gold from central banks in emerging markets."

The central community for the first time in 20 years is possibly going to be a net buyer of gold having been a net seller since 1988. However, some think Asian central banks may not hurry to follow India's lead given current record prices and the availability of cheaper domestically produced gold.

David Thurtell, analyst at Citi said, "Indian buying was very significant, but those getting excited about the potential for copy cat moves need to consider a number of factors." Culturally, India is more favourably disposed to gold than every other country. Secondly, it might be politically dangerous to be accumulating reserves at the all-time price high."

Trading volume of gold declines as prices rise
It's no longer a safe haven as investors turn away

Investing in yellow metal may no longer be a safe haven as investors are taking a cautious call on buy and sell of gold these days. With gold prices touching an all time high, the participation in terms of trading volume is declining. In fact, the trading volume during October-November has halved in comparison to the volume during March-April this year.

According to the data released by World Gold Council, the demand for gold in India has gone down by around 49% during Q3 of CY09 due to high gold prices and weak dollar.

Experts say that **it is not the price but the speed** at which the prices appreciated which has impacted the volume. Currently major participation is coming from non-institutional players, and institutional players are hardly taking positions. So far the expected direction of the gold prices is concerned; experts say the prices in short term to touch Rs 18,000 per 10 gram after a small correction.

But in medium to long term, gold prices could fall considerably.

3.4 SILVER MARKET

No Slowdown in Demand

It's precious metal or industrial metal, either way, silver market experiences frenetic activity; Because it's easier to figure if you see it as a market with two intertwining strands; Its demand, supply and prices each have two independent dynamics at work. The dichotomy and influence of these strands on each other makes this market no place for old men.

Consider supply: The world gets silver from silver mines, and what governments and people sell. In 2008, supply crossed 28,500 tonnes. Silver mines accelerate production when prices are attractive. People and governments too sell their family silver when prices are attractive. While prices plummeted after the financial crisis last year, silver sales plummeted too. But, the world also gets a huge quantity of silver as a by-product of lead, zinc, copper and gold mines. As these mines are focused on the price of their primary metal, they continue to produce silver irrespective of its price signals. Put together, you can never bet silver supply will directly respond to prices.

There is a similar dichotomy at work in demand as well. On the one hand, silver is brought as a precious metal to hedge against inflation, currency fluctuations and general economic malaise. So whenever there is fear and panic in the market, people gravitate towards silver. On the other hand, silver is simply another raw material used by factories in making everything from camera films to jewellery, electronics, batteries, hi-tech clothing and radio frequency tags. Actually half the silver sold is consumed like this. When factories slow down, as they did in the last one year, silver demand drops too. So demand for silver is a see-saw between its avatar as a precious metal and its day job as an industrial metal. The global recession which wrote off silver's industrial consumption also re-ignited its bullion demand.

How money flows into silver is an equally motley mix. Investors – these could be households, wealthy individuals, exchange traded funds and institutions – believe silver is a store of value and buy it in the form of paper, coins and bars. Ignoring silver's physical demand-supply fundamentals, they trade in silver the way they would gold and closely track the price relationship between the two.

A few far-sighted investors are not bothered about the gold-silver connection. Instead, they are putting their faith in silver's physical demand-supply fundamentals. Though demand for silver to make photography films has sharply dropped in the age of digital cameras, these investors believe supply would not keep pace with total industrial demand in the coming years. While a lot of above-ground silver would continue to re-enter the production cycle each year, investors are hopeful the world will find new commercial uses to suck it out too.

The punters, however, believe silver is simply a shorter route to profit than gold. They speculate on short-term price movements on commodity exchanges and use both long and short instruments to gain exposure to silver price. Punters know that in terms of value, the physical gold market is much bigger than silver. Being smaller markets the silver market less liquid and more susceptible to volatility. In short, it is perfect for getting over-the-top money if you have the courage to bet on it. The combined motives and trading strategies of investors and speculators keep the silver market full of frenetic activity.

Where does that leave you? With two choices obviously! You could put your faith in silver as a precious metal and hope its value will rise in line with gold. Or you could see it as just another metal that sometimes even moves in tandem with copper and is currently plagued by lack lustre physical consumption. One thing is certain. Both ways will bring you plenty of excitement.

4.0 FINANCIAL SECTOR: TRANSFORMING TOMORROW

New Economic Thinking

The economic and financial crisis has put many long-standing ideas to the test. But there is, in fact, economics has generated a wealth of ideas. Behaviour economics, for example, emphasises that market participants often act in ways that cannot easily be reconciled with rationality. And the crisis has provided ample evidence that market participants are far from rational.

Therefore, in the world of human fallibility and imperfect understanding of the complexity of the economy, action at national level culminates into costly market imperfection.

4.1 FINANCIAL ADVISORS:

Weigh impact on investors: The script starts to go wrong …

Concerted actions

It is tempting to believe that policymakers have engineered a Houdini-like escape from what was supposed to be Great Depression 2.0. A combination of various policy measures has magically resorted confidence in the financial system that looked all set to crumble a year ago. Economic data have systematically surprised on the upside since March this year indicating some sort of a synchronous global growth recovery despite the large debt overhang in the system.

Even though policymakers may have been successful in preventing the global economy from falling into an outright liquidity trap, there are now increasing signs that they are not getting the desired results in terms of fostering a sustainable recovery. A lot of the excess liquidity pumped into the system is heading towards unproductive assets in a way that could derail the comeback story.

This worrisome trend more evident in the commodity pits. The near vertical rebound in commodity prices is highly unusual in the early stage of the economic cycle especially when the underlying demand and supply fundamentals are still so weak. Massive inflows of financial capital are propelling commodity prices higher as investors and speculators buy the asset class to just make an anti-dollar play or because cheap money has their speculative juices flowing.

Nearly $35 billion has flown into commodity Exchange Traded Funds or ETFs that are a popular way for investors to gain exposure to commodities. The number of commodity ETFs outstanding has surged to 12 million compared to just three million in February this year. Speculative turnover in the commodity markets is also huge. Estimates put the daily trading volume of futures contracts in the energy space at a staggering 15 times of underlying demand. The norms, just five year ago, for trading volumes of various commodities was four to five times of actual demand.

Huge trading volumes and the resultant increase in price volatility of oil and other commodities are scaring away genuine producers and consumers looking to hedge their underlying exposure. They do not want to be caught on the wrong side of a trade, as accounting for large hedging losses or gains in their quarterly results has the potential to dwarf core profitability.

The commodity price rally during the initial stages of the economic recovery was not in the script of policymakers. Food and energy prices – the biggest contributors to inflation in many countries – usually remain relatively low so early in an economic upturn. Central banks then do not have to worry about inflation until the recovery is well entrenched.

Food and energy account for one-third of the consumer basket in developing countries and with prices of various agricultural commodities vegetables to sugar also joining the commodity party, inflation worries are surfacing rather prematurely in the economic recovery cycle.

Property prices, especially in many Asian countries, have also started rising a bit too quickly for comfort. Residential property prices in cities such as Hong Kong and Singapore have appreciated by 30-40% from a year ago and are nearing their peak levels. Prices are increasing particularly rapidly in financial centres suggesting speculative money is at play. This is evident in India as well where Mumbai has seen the sharpest recovery in prices while the uptrend in many other cities has been more gradual.

The concerted and vigorous actions of policymakers across the world to revive the global economy are now doing more to reflate asset prices rather than lift economic growth. The realisation that easy money alone cannot create economic growth and the adverse consequences of just pumping liquidity into the system are likely to dawn upon investors and policymakers alike in the months ahead.

4.2 FINANCIAL PLANNERS

Value unlocking for all stakeholders: Echo bubbles are hardly uncommon …

Echo bubbles

Commodity bulls spin the stories for rising prices. But hard numbers just don't back that claim. Oil and agricultural commodity prices typically tend to rise sharply during the late stages of an expansion when supply becomes tight following strong demand for many years.

It is incredible that oil and many other commodity prices are now trading well above the average price that prevailed during 2003-07 economic boom even though demand is yet to recover. The price of oil at that time was trading at around $70 a barrel. (Oil prices then doubled between August 2007 and June 2008 due largely to speculation).

In the past, oil prices have only risen when the spare capacity was below 5%.

Global spare capacity is currently running at 8%
Indeed, world oil demand is set to contract in 2009 for the first time since 1983.

During previous expansion phases in the US dating back to 1970, the stock market on an average rose 30% six months after hitting a bottom while commodity prices were more or less flat over that period.

This time around, prices of metals and oil have risen by almost the same magnitude as the already outsized 50% jump in the US stock market from its March lows.

To be sure, China has a structural shortage of many commodities and its decision to build strategic stocks has contributed to the recent upswing in commodity prices.

Developed countries are maintaining a low interest rate regime. And at such a low prevailing interest rates, the cost associated with hoarding inventories is insignificant.

It is remarkable to see how emboldened speculators in commodities have become all over again just a year after the rout they faced when the bubble burst. **'Echo bubbles'** are hardly uncommon in history.

In several instances bubbles in the same asset class have resurfaced shortly after the original boom-bust cycle as it takes a long time for an idea to die and easy money conditions created to deal with the slump often end up reflating the same old notion.

However, echo bubbles typically tend to be of a lesser magnitude as the original bubble.

While both policymakers and market participants are slow to learn lessons from their previous mistakes, they do not completely forget the painful consequences of the previous boom-bust experience, suggesting the current run up in commodity prices will not be anywhere as large as the previous move.

In addition, any surge in commodities has to be self-limiting.

If the easy money-driven economic recovery rolls on in its present form then oil prices will soon be back at close to \$100 a barrel. Such a price shock will be too much for the global economy to handle; oil close to \$100 a barrel will have the same debilitating effect on consumer balance sheets as oil at \$150 a barrel had last year. Consumer incomes in many economies have shrunk from when oil traded close to \$150 a barrel. At \$80 a barrel now, oil is already draining away more resources from consumer wallets and offsetting much of benefit from the stimulus plans.

4.3 WEALTH MANAGERS

Map out the details to translate into benefits: Counterproductive Chinese hoarding …

Commodity reserves

To be sure, China has a structural shortage of many commodities and its decision to build strategic stocks has contributed to the recent upswing in commodity prices.

The recent financial crisis and global meltdown that followed has led to a sharp downturn correction in prices of commodity-based raw materials. China, a large commodity consuming country, is making use of this price correction to build up its stock piles of commodity reserves. The average base metal inventory in China has doubled during 2009 while copper inventory alone has gone up four times.

However, this build up of stocks by China of copper, aluminium, iron ore, crude oil and other commodities during the past one year or so appears to have continued beyond a reasonable levels and does not justify consumption-based stocking even during normal times. In the current scenario of the worst-ever economic crisis since the 1930s, China is also aggressively acquiring metal and energy assets in Africa, Latin America, Australia and other parts of the world.

There are possibly more reasons than just ensuring raw material security behind this inventory buildup. China is, probably, diversifying investments from US treasuries to more stable commodity assets. While central banks of many countries, including China are increasing investment in gold, China appears to be using its forex for acquiring a basket of high consumption commodities also, both as a hedge against inflation and also as a hedge against possible raw material scarcity in future.

But, China's economy – which highly dependent on export of manufactured goods – would not be able to consume its' large stock of raw materials alone, in post-crisis consumption scenario, either through an increased domestic demand or through increased exports of goods to traditional consumers. This can be seen from a disappointing consumer spending data from the US, UK and other countries of Europe.

Although the recovery of metal and energy prices during the last few months is likely to bring short-term benefits to China with an inventory stocked at a price that is 10-20% lower than prevailing prices, its judiciousness in improving macroeconomic competitiveness is doubtful since there is a speculative element in such an approach, and is not a recommended long-term strategy of state policy.

Besides, this has a potential to redefine some established principles of production economics such as just-in-time inventory strategy (JIT). Ever since Henry Ford initiated "door to floor" concept backed by an efficient freight management system, which was later adapted by Toyota Motor to overcome the problem of warehousing in land-starved Japan. JIT has been extensively used by manufacturing firms across the globe to have right material, at right time, at right place, and in exact amount, with an aim of boosting return on investments of businesses by reducing in-process inventory and its associated carrying costs.

Unless the large commodity purchases are converted into manufactured goods for domestic consumption or export, this inventory buildup has a potential to generate another bubble, which can have even serious consequences for global economy that has just started showing signs of recovery.

4.4 INCLUSIVE CEOs

Innovative responses to problems: The $ reserve currency conundrum …

Dollar conundrum

Over the last few months discordant notes have been emanating from several countries holding large dollar reserves questioning the special safe haven status enjoyed by the dollar and the inability of the US as the issuer of the global currency to maintain its value.

With the dollar depreciating by upwards of 20% vis-à-vis the major currencies – euro, yen and British pound since the onset of the global financial crisis, there is an urgent need to arrest the falling value of the dollar reserves of the reserve holding countries.

America being the issuer of a global currency is indeed a special privilege enjoyed by the issuer country.

But along with this privilege comes the possibility of running large current account deficits because of the requirement to supply large quantities of currencies. There is also an additional consequence of a potential loss of export competitiveness on account of the possible appreciation of the currency if it becomes a popular reserve currency. There are understandably limits to current account deficits and currency appreciation that the issuer country can sustain and this is the reason why other currencies have not been able to significantly displace the dollar as the global currency of choice.

With the increasing role of China in international trade, the renminbi can become a reserve currency over time but this will require the country to abolish capital controls and allow its value to be determined in the free market that will inevitably lead to the weakening of the vice like grip of the Chinese government on its economy.

It is worth recapitulating the process by which the global economy currently finds itself in dire straits. Unbridled consumption by US citizens, US buyouts of foreign companies and the massive US military spending across the world – all paid for in the domestic currency of the US – find their way ultimately to the foreign central banks of the countries that have balance of payment surpluses.

- These dollars are effectively recycled by the central banks back to the US when they invest in "safe" financial assets like US treasury bonds.
- The other alternative for these surplus countries is to let their currencies appreciate in the free market relative to the Dollar with negative ramifications on their export competitiveness, the health of their export intensive businesses and unemployment.
- As long as the export surplus countries continue to hoard dollars which is effectively US IOUs, despite being the world's largest debtor country, the US does not have to undergo IMF style "structural adjustments".

The standard prescriptions under 'structural adjustment programmes' are tax and interest rate hikes, currency devaluation, reduction in trade and fiscal deficits, pruning social safety nets, selling government-owned enterprises and natural resources, etc., to the satisfaction of pressing creditors. However, it is surprising to note that the US response to the financial crisis over the last two years is at complete variance to the "standard" operating procedure in a structural adjustment programme.

The fall of the once mighty British pound as a reserve currency between the two World Wars, a defeated Japan in the second World War becoming an economic powerhouse, and more recently, the leap of Communist China from utter poverty to relative prosperity – all in a few decades – are examples worth recalling. It is therefore reasonable to prophecy that the longer the US continues to live off the savings of others, the more likely it is that the laws of economics would catch up with it some time.

Russian President Dmitry Medvedev has recently presented an interestingly different perception about the state of the world stating that the artificially maintained unipolar system was based on: one big centre of consumption financed by a growing deficit and thus growing debt, one formerly strong reserve currency, and one dominant system of assessing assets and risks. He went on to castigate the US military presence across the world survives on what is effectively a massive subsidy by the rest of the world.

Indeed, to the lay observer it appears that the global reach of the mighty military prowess of the US sits rather uncomfortably with the perceptible decline in its economic strength. These apparent contradictions would possibly take decades to get reconciled but history has been witness to many events that appeared incredulous when the first undercurrents were visible.

4.5 CREDIT COUNSELORS

Resolve convertibility and recompensation issue: Death by renminbi …

Under-valued renminbi

The dollar depreciation against the euro and yen has grabbed global attention at present. In normal world, the dollar's weakening would be welcome, as it would help the US come to grips with its unsustainable trade deficit. But, in the world where China links its currency to the dollar at an under-valued parity, the dollar's depreciation risks major global economic damage that will further complicate recovery from the current worldwide recession.

A realignment of the dollar is long overdue. Its overvaluation began with the Mexican peso crisis of 1994, and was officially enshrined by the "**strong dollar**" policy adopted after the East-Asian financial crisis of 1997. That policy produced short-term consumption gains for America, which explains why it was popular with American politicians, but it has inflicted major long-term damage on the US economy and contributed to the current crisis.

The over-valued dollar caused the US economy to haemorrhage spending on imports, jobs via off-shoring, and investment to countries with under-valued currencies. In today's era of globalisation, marked by flexible and mobile production networks, exchange rates affect more than exports and imports. They also affect the location of production and investment.

China has been a major beneficiary of America's strong-dollar policy, to which it wedded its own "**weak renminbi**" policy. As a result, China's trade surplus with the US rose from $83 billion in 2001 to $258 billion in 2007, just before the recession. So far in 2009, China's surplus has accounted for 75% of the total US non-oil-goods trade deficit. The under-valued renminbi has also made China a major recipient of foreign direct investment, leading the world – a staggering achievement for a developing country.

The scale of recent US trade deficits was always unsustainable, and the dollar has therefore fallen against the yen, euro, Brazilian real, and Australian and Canadian dollars. But China retains its under-valued exchange rate policy, so that the renminbi has appreciated relatively less against the dollar.

When combined with China's rapid growth in manufacturing capacity, this pattern promises to create a new round of global imbalances.

China's policy creates adversarial currency competition with the rest of the world. By maintaining an undervalued currency, China is preventing the US from reducing its bilateral trade deficit. Furthermore, the problem is not only America's. China's currency policy gives it a competitive advantage relative to other countries, allowing it to displace their exports to the US.

Worse still, other countries whose currencies have appreciated against the renminbi can look forward to a China import invasion. China's currency policy means that dollar depreciation, rather than improving America's trade balance and stanching its leakage of jobs and investment, may inadvertently spread these problems to the rest of the world. In effect, China is fostering new imbalances at a time when countries are struggling with the demand shortfall caused by the financial crisis.

The dollar is part of an exchange-rate Rubik's cube. With China retaining its under-valued currency policy, dollar depreciation can aggravate global deflationary forces. Yet a mix of political factors has led to stunning refusal by policymakers to confront China.

On the US side, a lingering Cold War mentality, combined with the presumption of US economic superiority has meant that economic issues are still deemed subservient to geo-political concerns. That explains the neglect of US-China economic relations, a neglect that is now dangerous to the US, given its weakened economic condition.

With regard to the rest of the world, many find it easy to blame the US, often owing to resentment at its perceived arrogance. Moreover, there is an old mentality among Southern countries that they can do no wrong in their relationships with the North, and that they should exhibit solidarity with each other regarding those relationships.

Finally, all countries likely have been shortsighted, imagining that silence will gain them commercial favours from China. But that silence merely allows China to exploit the community of nations. The world economy has paid dearly for complicity with and silence about the economic policies of the last 15 years, which have culminated in the deepest and most dangerous recession since the 1930s. It will pay still more if policymakers remain passive about China's destructive currency policy.

4.6 RISK MANAGEMENT CONSULTANTS

Educate – Engineer and Enforce: Response to rising fund inflows mooted …

Rupee appreciation

Strong foreign capital flows in the initial months of the current financial year (2009-2010) have the policymakers worried and has send them scurrying for options, including a coordinated response by leading Asian economies to preclude interventions on local currencies by some countries.

If some countries intervene to prevent their currencies from appreciating, India's interest could be hurt given its limited room for intervention. India's exports would become less competitive, hurting the employment intensive sector.

Indian rupee in mid-November against dollar is near 46.50. India saw foreign investments inflows of $27.5 billion in April-August 2009. At this rate, these inflows could cross the $ 61.6 billion for entire 2007-08, the year country faced a serious foreign inflows problem and had to take measures to discourage them, including restrictions on portfolio inflows and external commercial borrowings.

In India, tightening of policy rates in view of inflationary pressures could lead to interest rate differential vis-à-vis developed economies and result in higher inflows.

Will capital inflows be modest or turn into a flood as in 2007? The latter concern is particularly relevant in view of abundant liquidity in the major advanced economies.

What will the implications be for exchange rates? In India, the current account is in modest deficit; hence large and volatile capital flows can impose macroeconomic costs.

India's ability to intervene and manage the exchange rate may be constrained due to domestic compulsion such as inflationary pressures and large government borrowings. While inflationary pressures rule out unsterilised intervention, large government borrowings-needs will come in the way of sterilised intervention. Foreign currency inflows cause the rupee supply to increase, which has to be mopped up through issue of bonds to control money supply and check inflation. This is called sterilisation, but it pushes up interest rates, which will increase government's borrowings costs.

In such a situation, where India will have to allow its currency to appreciate gradually, intervention by other countries to keep their currencies down could erode India's exports competitiveness. A pledge to refrain from such intervention by Asian economies will help India.

Capital flows have already begun to move towards emerging markets.

Countries such as India, Brazil have begun to witness rise in inflows raising concerns on their exchange rates. Following a 33% appreciation in its currency in the current calendar year, Brazil has already imposed a tax on capital inflows. However, the proposal for a coordinated approach on managing exchange rate is unlikely to cut ice with policymakers in India itself.

Firstly, there are questions about whether such a coordinated non-interventionist approach with regard to exchange rate can work within countries as most may not be agreeable to cede ground on this. Second, India itself would not like to lose its flexibility to manage its exchange rate.

4.7 TECH SAVVY PROFESSIONALS

Take first step to ensure efficient and reliable system: The next big bubble…

Bubble monster

Nouriel Roubini, New York University Economist, whose dire warnings about a financial crisis proved depressingly prophetic, writing in *The Financial Times*, warned that the Federal Reserve and other government central banks are fueling massive new asset "bubble" that – while not in imminent danger of bursting – will someday do so with calamitous consequences.

Here's Roubini's argument. The Fed is holding short term interest rate near zero. Investors and speculators borrow dollar cheaply and use them to buy various assets – stocks, bonds, gold, oil, minerals, and foreign currencies. Prices rise. Huge profits can be made. But this will stop someday, Roubini warns. They will eventually raise interest rates. Or outside events (a confrontation with Iran, fear of a double-dip recession) will change market psychology. Then, investors will rush to lock in profits, and the sell-off will trigger a crash. Stock, bond and commodity prices will plunge. Losses will mount, confidence will fall and the real economy will suffer. The Fed and other policymakers seem unaware of the monster bubble they are creating. The longer they remain blind, the harder the markets will fall.

Like home values a few years ago, asset prices have risen spectacularly. Since its March 9 low, the US stock market has gained more than 50%. An index of stocks for 22 "emerging markets" countries (including Brazil, China and India) has doubled from its recent low. Oil is about $80 a barrel has increased 150% from its present low of $31. Gold is near an all-time high above $1,100 an ounce. Meanwhile, the dollar has dropped against many currencies.

This half of Roubini's story resonates. But the other half is less convincing that prices driven by cheap loans have reached speculative levels.

Remember that the economy seemed in a free early this year. Terrified consumers and cautious companies hoarded cash, cut spending and dumped stocks. Since then, the mood and economic indicators have improved. Higher stock and commodity prices have mostly now recovered the big losses of those panicky months. Today's prices are usually below previous peaks. Oil's peak was nearly $150 a barrel. Similarly, the S&P500 stock index, around 1,050, is a third lower than its peak on October 9, 2007 (1565.15), and roughly where it was on Election Day 2008 (1005.75). By historical price-earnings ratios – the ratio of stock prices to per-share profits – these levels can be justified, *if the economic recovery continues*. With massive layoffs, business costs have been cut sharply.

It is also not clear that cheap dollar loans are promoting speculation.

In the US and Europe, banks are reducing lending. Economist Hung Tran of the Institute of International Finance, a research organisation of financial Institution says, "Hedge funds taking on less leverage than in 2007. What actually happened is that as investors become less fearful, they moved funds from cash into other markets. For instance, this year outflows from money market MFs exceeding $ 300 billion".

Indeed, that's what the US Federal Reserve wants, argues economist Drew Matus of Bank of America; Low interest rates on money market funds and checking accounts are "trying to force you to do something with it (the money)" – either spend it or invest it. Depression prevention means supporting consumption and asset markets.

So, Roubini's new bubble remains unapproved. But this doesn't invalidate his warning. We've learned that there's a thin line between promoting economic expansion and fostering bubbles. With hindsight, lax Fed policies contributed to both the "tech" bubble of the late 1990s and the recent housing bubble.

The most worrying signs of speculative excesses, says Hung Tran, involve some Asian and Latin American developing countries. They have received sizeable capital inflows (money from abroad). These have boosted local stock markets and reflect disaffection with the dollar. Their central banks – imitating the Fed – have also kept local interest rates low, fuelling rapid credit growth. Some of their stock markets have exceeded previous highs. These countries face a dilemma. Raising rates may attract more "hot" foreign capital: keeping them low encouraging speculative borrowing in local currency.

But the dilemma arises from the Fed's low interest rates and the weak dollar. The conclusion: How deftly the Fed navigates from its present policy matters for the world as well as the US. If it's too fast, it may kill the economic recovery. If it's too slow, it may spawn bubbles – and kill the recovery.

4.8 MICRO-FINANCE PROFESSIONALS

Developing alternative credit delivery models: Structural coordination of regulators

Regulatory arbitrage

One of the common identified causes of the global economic crisis which the world is yet limping out is the inefficiency of regulatory design – a permissive regulatory regime based on excessive reliance on the private sector, leading to inefficient oversight.

Apparently, this permissive approach was prompted by a desire to promote creativity. Ineffective oversight was*, inter alia*, rooted in the underpinning belief that markets are a better regulator, which was further compounded by the multiplicity of regulators and inefficacious coordination amongst them.

There is a rethink on the regulatory design. In fact, there is now a coordinated and concerted attempt among regulators in all geographical jurisdictions not only to revisit and reengineer but comprehensively revamp the regulatory approaches, frameworks and processes.

Knee-jerk reactions in some countries are also perceptible. Actually, some jurisdictions want to further burden already overburdened central banks with the responsibility of regulating financial institutions even beyond pure banking. Even though unbridled creativity has been one of the banes of the financial mess, shackling of creativity can torpedo and even choke the process of further economic growth. It is, hence, important that regulatory tightening does not suffocate the process of economic growth.

It is our view that regulations should be potent enough for orderly development of the market and prevention of misconduct. This is achieved by laying down ground rules, managing compliance, solving problems and controlling risks: structural, systemic and operational. Regulations should facilitate rather than be prejudicial to development. Rapidity and profundity of changes in the environment ethos do dictate that the regulations should be dynamic, forward looking and collaborative. It is not possible to shoot a moving target from a static gun position. Though each regulator, in his anxiety to comprehensively and assiduously regulate, eventually tends to tread on the turf of other regulators, he still leaves regulatory gaps with ample scope for misconduct in the absence of coordination among regulators. This is being termed as regulatory arbitrage. Regulatory gaps have been an area of serious concern.

The financial services sector, as it has evolved, particularly during the last decade, often makes it difficult to decipher when the jurisdiction one regulator ends and that of the other begins.

And this is more pronounced in the case of institutions have become umbrella organisations and undertake various lines of business – banking, insurance, asset management, pension, broking-equity (cash and future) and commodity trading (spot & future) – which are regulated by three or four different financial regulators. India visualised this issue some time towards the end of 2003 and the high-level committee (HLC) – an informal body comprising the RBI governor, Sebi chairman, Irda chairman and the finance secretary – was created as a sub-efficient mechanism to monitor the functioning of such systemically important financial institutions (sifi). Even though the process continues, there is still enough room for improving the intensity and depth of coordination.

In various geographies, different forms of regulatory frameworks have been tried. These are separate regulator for each segment of the financial market, middle path where regulation of some of the segments is aggregated and that of other left to separate regulators, and a consolidated regulator like the Financial Services Authority (FSA) of the UK.

Yet another set of regulatory structures has been in the shape of driver of regulations: government, independent regulators and/or a mix of both. While the merits of each of regulatory framework can be debated, the fact is that the global financial mess occurred under all regulatory frameworks.

The design of the next-generation regulatory framework has been engaging the attention of G20. However, there is near consensus that extraordinary tightening of regulation will impede economic growth and, hence, should not be pursued. The deeper coordination among different sets of regulators has, therefore become eminently essential.

The current coordination among financial regulators in India is more informal than formal, and certainly not legislatively structured. There is an urgent need to legislate a coordinated structure where all the regulators formally sit to coordinate and ensure that the action of one regulator is in consonance with that of other regulators, and together leave no regulatory gaps or opportunities for regulatory arbitrage.

To be effective, the coordinating structure has to be outlined through legislation that must cover the role, responsibility and accountability of the regulators represented in the coordinating body.

The legislation should also attempt to delineate the boundaries of each regulator and rest in the coordinating body the authority to decide the regulation of the disputed space in case of doubt.

The law should also outline the mechanism of coordination, which should include frequency of meeting, the presiding officer, members and procedure that goes into designing the broad architecture of the processes for the smooth functioning of such a body. This body should be answerable to Parliament.

The suggestions made above might appear to be a unified regulator, but that is not the intention. Whereas individual regulators will continue to regulate their respective jurisdictions, the coordinating body will make sure that the regulators function in tandem and do not work at cross-purposes. The proposed structure should become a clearing house where disagreements on various areas can be sorted out. This is important, particularly in the Indian context, because our markets are still developing. Some segments necessary for faster economic development – such as a debt market – have been mired in disagreements over regulatory jurisdiction and the desired coordination mechanism.

The coordinating body can also be made to look at new initiatives to develop national markets, to achieve faster growth and emancipation of millions of Indians.

4.9 CONTINUING LEARNING CENTRES

Take informed decisions: Let host nation regulate foreign finance

Host country regulation

One of the mantras of the last decades in international financial regulation has been the need to create a level playing field for all financial institutions (FIs) operating in international markets.

On the face of it, this logic is difficult to beat. It sounds meritocratic, fair and responsible. Surely, the costs of capital would, in theory, be lowered and access to international credit markets would increase. And rates of economic growth could be enhanced. All of these benefits should be provided by an international financial system in which a level playing field was in operation.

However, even before the most recent global financial crisis, we knew that the idea of a level playing field did not make accessing capital easier for all involved in the game. International financial accords, such as the Basel-II principles for international financial regulation, favour large FIs from the most advanced economies. Those institutions having strong IT capabilities and complicated risk management models were considered superior players on the level playing field.

The level playing field was only equal in the abstract, but highly unequal in its effects. Academic research on the impact of the Basel-II accord has demonstrated that it raised the costs of capital for institutions from developing economies. At the same time, the accord permitted large FIs from advanced economies to lower their costs, in part through investment into securitised debt.

One important element of the level playing field argument has been the stress placed on home country regulation within international finance. This is justified on the grounds that sound regulation within major advanced economies will make international finance more secure, especially in dealing with developing economies. We know from the last two years that this is far from true – It can act as a source of instability. It permits large FIs to be used as a tool of foreign economic policy. Scholars of financial history can point to various incidents where public officials have placed pressure on foreign governments to open up their economies. The point here is that foreign governments use large FIs as tools of foreign economic policy. They expand their foreign market share while avoiding local regulatory requirements that would be enforced under a host regulatory system.

An international financial system based on host rather than home country regulation makes much more economic and political sense. Economically, it makes sense because if a foreign institution is required to establish a subsidiary that in under the supervision of the host regulator, the institution must provide adequate and sufficient financial information on its risks.

A host regulator can ensure that certain institutions are not lending recklessly in a manner that leads to artificial asset booms. Host regulators can enable counter-cyclical charges on institutions creating such booms within a broader framework of national macro-prudential regulation. A host regulations can also more easily cool down 'hot' capital flows through the imposition of controls, if need be, as well as place restrictions on foreign borrowing should an unsustainable carry-trade emerge.

Importantly, a host regulation can monitor the overall behaviour of institutions within a national system rather than relying on unevenly implemented global standards that stress micro-prudential regulation and fail to identify system-wide risks. For these reasons, host regulation makes good economic sense and would have alleviated many of the problems that have caused the current crisis.

The Warwick Commission on International Financial Reform has noted that India's system of host regulation has both empowered and insulated the economy from some of the worst excesses of the crisis.

We suggest that a system of host country regulation also makes good political sense for three reasons.

The 1st reason is that host regulation provides a greater capacity for governments to encourage links between the financial system and the real economy in the pursuit of national economic and social goals.

The 2nd reason is that it permits greater diversity in the world economy on types of financial institutions and financial activity. Such diversity is important not only in permitting a better allocation of capital as countries offer different incentives for investment, but also avoiding regulatory 'groupthink', where regulators are trapped within an intellectual framework that can easily falter.

The 3rd reason is that host regulation stops more advanced economies from using their large financial institutions as tools of foreign economic policy and empowers their economies to make their own choices.

4.10 ONE-STOP-SHOPS

Dedicated to offer related services under a roof

GDP fetishism

Joseph Stiglitz, chair of the Commission on the Measurement of Economic Performance and Social Progress says, "GDP is an attempt to measure what is going on in our society. It is what I call GDP fetishism to think that success in that part is success for the economy and society".

In 2008, French President Nicolas Sarkozy dissatisfied with the available tools of economic assessment and concerned about the increasing gap between the information contained in aggregate GDP data and what counts for common people's well-being. Sarkozy created a commission, chaired by Joseph Stiglitz and Amartya Sen. The commission, which submitted its report on September 15, 2009, has highlighted the urgent need to broaden the coverage of statistics in the light of the recent crisis.

The authors argue that "those attempting to guide the economy and our societies are like pilots trying to steer a course without available compass". The single-minded fixation of policymakers on increasing GDP, which they mistook for economic well-being, entailed many wrong decisions.

GDP was measured using market prices and, given the bubbles in the prices of assets, it sent out misleading signals. What we measured was wrong and, therefore, what we did was wrong.

The main message of this report is that the time has come for our measurement system to shift emphasis from measuring economic production to measuring people's well-being and sustainability. But that does not in any way undermine the importance of GDP and production measures.

In fact, the Commission recognises that there is no single measure that can encompass everything and, instead, proposes various dashboards of indicators that allow people to construct different composite indices. The report looks at three issues in developing alternative metrics. **The first issue** identifies the limits of GDP as an indication of economic performance and social progress, including problems with its measurement. GDP takes no account of depreciation and non-market activities; it ignores distribution issues and doesn't adequately capture improvements in the quality of goods and services.

The second issue focuses on improving measures of 'quality of life' or 'well-being'. The Commission recommends steps to improve measures of people's health, happiness, education, personal activities and their environmental concerns. It focuses on getting reliable measures of social connections, political voice and insecurity that determine life satisfaction.

The final issue the report raises is that of sustainability. Economic activity is sustainable if future generations can be as well off as the current one. Their well-being, in turn, depends on the stock of capital – physical, natural and human – that we pass on to them. The report argues that environmental aspects of sustainability deserve a separate follow-up. The Commission proposes various dashboards of indicators but it does not come up with a quick and easy way to tabulate a new measure of well-being.

However, the report is timely in the light of the recent financial crisis. Maybe this time policymakers will realise the heavy price paid for their 'GDP fetishism' and broaden metrics to look beyond measures of market production. With the political weight of Sarkozy behind this report and leading academics at the helm, the task will be a bit simpler this time round.

4.11 GLOBAL OUTLOOK

Global pathways: Global Trends 2025

A transformed world

Director of National Intelligence Dennis C Blair, who serves as the head of 16 top US intelligence agencies, said, "We have some new players – Brazil and India – that now have a seat at the table of global influence". With new players like India and Brazil taking a seat at the table of global influence, the international system that emerged at the end of World War-II is being transformed. The roles of Russia and China have also changed considerably. And there are new stakes and new rules for everybody, he said speaking at the World Affairs Council of Philadelphia, Pennsylvania,

Blair recalled that the National Intelligence Council (NIC) had last year, in a set of long-range projections entitled "Global Trends 2025: A Transformed World", projected that "the international system that we've known since the end of World War II is being transformed."

- A year later, Blair said, "The G-8 has decidedly become the G-20. You notice who just got the 2016 Summer Olympics? Rio de Janeiro. And which movie won the Academy Award for Best Picture in February? 'Slumdog Millionaire', a film about transcending poverty in Mumbai."

A second major projections made by NIC was that a total breakdown of the current system in unlikely, but the transition to a new global, multipolar system won't always be smooth. "There's also going to be an unprecedented transfer of relative wealth moving from West to East." It's already under way; and it's going to continue in that direction for a foreseeable future.

- Many emerging market countries such as China, India and Brazil have weathered the global financial recession better than the industrialised democracies – they've actually experienced faster recoveries.
- Many economists expect that trend to continue. But Russia has lost ground economically.
- The recession also undercuts efforts to reduce poverty in the world's poorest nations.

The third takeaway from Global Trends 2025 was that even though things will be rocky for some countries in the short term, there's going to be greater global prosperity in the long term, Blair said.

- Unfortunately, there will be a wide array of transitional challenges like energy security, resource scarcities, climate change, proliferation and terrorism.

The fourth takeaway from the report was that the potential for conflict – both between nations and within nations – is likely to grow, not shrink. It's still too early to tell whether this forecast will be fully realised or more importantly, can be stopped, Blair said. "What I can say is that the risks of greater or endemic conflict – especially in the Middle East and South Asia – haven't lessened over the past year. When you combine this with such a diverse range of threats – including terrorism, drugs and crime – it makes it difficult to see any lessening of the security challenge for the US and our allies".

4.12 ISSUES OF THE PRESENT

Freedom to get & fail in the system of free enterprise

Bernanke's growth formula

Federal Reserve chairman Ben S Bernanke has succeeded in returning the US economy to growth after the longest contraction in more than six decades. So far Wall Street, not Main Street, has been the primary beneficiary. Bernanke has helped spark a 62% rally in the stock market since March 9 by pledging to keep borrowing costs 'exceptionally low' for 'an extended period.' His efforts haven't stopped unemployment from reaching a 26-year high of 10.2% in October '09. The Fed's benchmark rate is already near zero and its balance sheet is just below a record at $2.14 trillion, leaving Bernanke, with little room to manoeuvre.

He may be faced with growth that doesn't generate many new jobs, while stocks keep rising because companies are cutting costs and meeting demand by improving productivity.

It's a good news, bad news story: Nariman Behravesh, chief economist at HIS Global Insight in Lexington, Massachusetts says, "It's a good news, bad news story".

The corporate sector is going to be in very good shape financially, and that's good for stock market. The bad news is that we'll continue to see job losses through next spring. The US economy strengthened for the first time in more than a year during the third quarter, expanding 3.5%. Much of the growth came from a surge in productivity that is helping employers meet demand without hiring.

The increased efficiency has boosted corporate earnings and stock prices. *Caterpillar,* the world's largest maker of bulldozers and excavators earned $ 404 million, or 64 cents a share, in the third quarter, far surpassing the analyst's forecast of 5 cents a share. The company, which saw sales fall 44% to $ 7.3 billion in the period, has slashed inventories and production and cut about 37,400 fulltime and temporary workers since December 2008. Its stock has gained 165% since March 2 low of $ 22.17.

Net income at *Home Depot*, the largest home-improvement retailer, dropped 7.2% in the second quarter to $1.12 billion. **Overall expenses were $ 20 million less than it planned,** and it earned 66 cents a share, 7 cents better than analysts had estimated. Its shares have risen 52% since the March 6 low of $ 18.

James Paulsen, chief investment strategist, at Wells Capital Management says, "Rising corporate profits will be the "seed corn" for a sustained economic recovery and future hiring." Edmund Phelps, who won the 2006 Nobel Prize in economics and teaches at Columbia University in New York says, "There's a whiff of joblessness in the recovery, because as long as firms are only looking in front of their nose, they're not going to reconstitute forward-looking jobs."

Diane Swonk, chief economist at Mesirow Financial says, “The credit crisis has also changed the dynamics of the recovery”. **It’s hard to get a small-business loan**; we’re still talking about tightening credit conditions in the sector that creates the most jobs. Swonk says, “This is a recovery that is very different, inhibited by the role that credit plays.” Commercial and industrial loans at US commercial banks dropped to $ 1.37 trillion as of November 4 from $1.6 trillion at the end of 2008.

Mohamed El-Erian, CEO of Pacific Investment Management, which runs the world’s biggest bond fund says, “The dichotomy between the surging stock market and lagging jobs market may end up posing problems for the central bank.” In seeking to avoid a depression occasioned by the financial crisis, the Fed now finds itself having inadvertently placed a large bet on a recovery driven by asset prices. The danger is that the Fed’s accommodative policy will push stock prices further out of line with the economic fundamentals of modest growth and high unemployment.

El-Erian says, “The Fed’s strategy, coupled with the federal government’s $ 787-billion stimulus package, also “faces the risk of collateral damage, including dollar pressure.” The dollar has fallen 15% since March against a basket of the most-traded currencies”.

Rising unemployment poses political perils for President Barack Obama and his fellow Democrats ahead of Congressional elections next November. Exit polls during state balloting earlier this month showed the economy was the chief concern of voters who elected Republicans to replace Democratic governments in New Jersey and Virginia. Obama said that he will convene business executives and experts for a jobs forum next month at the White House. “The economic growth that we have seen has not led to the job growth that we desperately need,” he said. “We have an obligation to consider every additional responsible step that we can to encourage and accelerate job creation in this country.”

5.1 BANKING SECTOR

Short Term Outlook

Bumpy road ahead

The profitability of Indian banks is expected to be under pressure over the next two quarters. The possibility of lower treasury gains and muted growth in net interest income (NII) is expected to curtail the growth of banking sector. The top 10 Indian banks made more than Rs 6,000 crore collectively from treasury operations in the first half of FY10 (April-March) against only Rs 220 crore in the corresponding period of the previous fiscal. This was possible because bond yields were declining and bond prices were moving up. However, a further softening of yields is unlikely.

RBI latest quarterly review of monetary policy indicates that we are at the bottom of a soft interest-rate regime. Thus, high treasury income earned in the first-half from government securities' (G-sec) portfolio may not recur in coming quarters. The central bank restored the statutory liquidity ratio (SLR) to 25% from 24%, in a bid to reduce the liquidity in the banking system and send out a signal that a further softening of rates is ruled out.

Interestingly, banks have piled up investments in G-secs: The aggregate G-sec investment of Indian banks increased by 42% as on October 2009 from the year-ago level. If interest rates were to rise, banks would have to incur mark-to-market losses. Public sector banks have high exposure to low-yield high-duration G-secs. They are more exposed to market risk than their private sector counterparts.

While treasury income is expected to decline, banks can derive solace from a likelihood of better growth in non-food credit growth in the second-half of the current fiscal. If the GDP is forecast to grow at 6-6.2% during FY10, a 15-16% growth in non-food credit cannot be ruled out. Since real activity is gaining momentum, metal and infrastructure companies will be major borrowers of bank funds.

Siddhartha Sanyal, chief economist of Edelweiss Securities, echoes similar views. Many factors influencing demand for the supply of credit have turned positive now. The demand for funds is likely to go up as working capital investment increases on account of a pick-up in industrial production and rising commodity prices. However, there is a catch here too. Banks had mobilised high-cost deposits in the second-half of the previous fiscal, leading to a contraction of their net interest margin (NIM), the difference between interest earned and paid.

Bankers say going forward NIMs will improve on the retirement of high-cost funds and mobilisation of low-cost deposits. However, that improvement will only be on quarter-on-quarter basis. On a y-o-y basis, spreads in December 2009 quarter will still be less than the corresponding period of the previous fiscal. Therefore, despite a pick-up in credit offtake, banks will find it difficult to grow NII as high-cost deposits will still have a lag effect. This will lead to muted NII growth, which coupled with low treasury gains, hints that banks will see a dip in their net profit in the second half of the fiscal.

Banks' profit to be under pressure in next 6 months	
Negatives	*Positives*
Lower treasury growth	Growth in GDP
Muted growth in net interest income	Revival in real activity

Moody's justifies negative outlook for Indian banking

Global rating agency Moody's has expressed concerns on the outlook for India's banking sector. In its latest report, Moody's has justified its negative outlook for Indian banking sector on the grounds of challenging economic conditions and the rising level of problem loans which will have an adverse impact on their asset quality. Though Moody's outlook for the Indian banking system remains negative, this view is unlikely affect the credit ratings of Indian banks.

Another factor that the ratings firm seems uncomfortable is the dominance of public sector banks (PSBs) with government-owned banks owning almost 72% of bank assets. The balance is held by private sector (19.6%) and foreign banks (8.5%). While foreign and private banks lack the size to pose a significant franchise threat to PSBs, their greater flexibility and more sophisticated infrastructure allow them to provide superior levels of customer service.

The main concern about the Indian banking system is the deteriorating asset quality and the volume of restructured loans. During fiscal year ending March 2009, absolute gross nonperforming loans (NPLs) for all Indian commercial banks increased by 22.5% compared with 11.9% in the previous year. Although the NPL expansion must be seen in the context of the problems faced by banks globally over the past couple of year, the rapid expansion of retail lending in recent years, combined with the slowdown of the Indian economy, appears to have led to increased delinquency rates, especially for unsecured retail loans.

Also, the future performance of restructured loans will determine the evolution of the NPL trend in India. Indian banks' profitability has been improving in recent years with core income benefiting from the high lending environment and net interest income rising sharply in FY 2009. However, in the short term, Moody's expects some of the rated entities' profits to be adversely affected by the recent Reserve Bank of India requirement that banks should increase their NPL provision cover ratio to at least 70% by September 2010. Moody's has advised banks to focus on increasing their fee-based income, as this will be the key to improving their quality of earnings and maintaining future profitability. A diversified earning profile would help PSBs improve their bank financial strength ratings (BFSRs).

Authorised capital of PSBs doubled to 3k crore

The government has decided to double the limit of authorised capital in public sector banks to help some Indian banks, which were unable raise capital. The raising of authorised capital from Rs 1,500 crores is a technicality which does not straight away strengthen the capital position of a bank. That has to be followed up with share sale which increases the paid-up capital that's key to calculating the capital adequacy ratio of banks which reflects the bank's strength. Indian banks have to maintain a capital equivalent to 9% of their deposits. Many state-run banks could not increase their lending substantially as they were not able to raise capital because they were already at the permitted authorised capital level.

Out of the 26 public sector banks in the country, the top 12 banks have already reached their authorised capital limits. The paid-up capital of Punjab National Bank, Canara Bank, Corporation Bank, Bank of Baroda, Union Bank, Bank of India is at 1500 crore. The largest public sector bank, State Bank of India has a paid-up capital of Rs 1000 crore. The relaxation of these would help these banks to sell more shares.

In whatever form the capital is infused, it will shore up Tier I capital and certainly go a long way in meeting requirements and more capital will back up credit expansion.

5.2 THE MONETARY POLICY

Policy Matters

The monetary policy has been announced and it's time for investors to realign portfolio. The same sectors and stocks don't remain favourites forever. So, post announcement, experts think that investors should revise their portfolios. While, with a change in the economic conditions, the outperformers become underperformers, many laggards start outpacing winners. Hence the investment portfolio has to be balanced after a certain period of time and post any policy change, which has a substantial impact on the economy and different investment classes.

While in the monetary policy most of the key rates such as repo rates, reverse repo and cash reserve ratio remained the same, the statutory liquidity ratio was raised from 24% to 25%.

Also, the Reserve Bank of India (RBI) made it more expensive to lend money to the real estate sector. Industry experts think that higher provisioning and a likely rise in interest rate may have a negative impact on the bottomline of banks.

It is seen that once the monetary policy was announced, banking and realty stocks declined substantially. In fact, BSE Realty is most hit among other BSE indices post announcement of the policy.

Given the current market conditions, investors should realign their portfolios in terms of their exposure to different sectors. A few months back, banking was a hot sector, whereas now experts suggest investors be a bit cautious on the sector. There is a unanimous view among the experts that negative impact of the monetary policy will be mainly on all interest rate sensitive sectors like banking and realty.

It's not just the monetary policy, in the last nine months stocks from these sectors appreciated sharply along with the equity markets and on aligning the gains with improving economic data, they do appear to be on the higher side, hence giving reason for the correction.

On the contrary, pharma, logistics and FMCG stocks should do well at this point of time. These are the sectors which underperformed in the Bull Run that started in March this year. Investing in well-managed companies in these sectors benefiting from higher domestic consumption will be a wise decision.

Experts are also suggesting holding a large cap portfolio of stocks that are not excessively affected by both a rise in commodity prices and interest rates. These sectors would be commodity mining (Sesa Goa, and Hind Zinc), Information technology (Infosys), infrastructure (L&T) and power (Tata Power). However, sectors such as banks, NBFC, real estate and autos are likely to be affected and one should be cautious in increasing exposure to these sectors.

Experts also offer an insight for investors investing in debt mutual funds. They say the interest rates may go up and that would have an impact on the returns of debt funds. Bank FDs, however, are preferred for short and medium-term investments. Recently, long-term bonds and gilt funds rallied since the expected interest rate hike did not come through. Investors could use this opportunity to move to FDs.

Investors should not just revise their stock portfolio but also the overall mix of debt and equity exposure. It should be kept in mind that the portfolio not only requires realignment of the stocks but also needs optimum balance between debt and equity. For example, if one started investing around 70% in equities & 30% in debt – with the surge in equities, exposure may have gone up to 90% and debt could be claiming only 10% of the total portfolio. So profit booking is essential to realign the portfolio.

6.1 TAX UPDATES

Growth is intact
Despite fall in Indirect tax collections

The Centre's indirect tax collection for April-October fell a steep 21.6% against the comparable figure for 2008-09. Does this negate the impression of manufacturing recovery suggested by the growth of index of industrial production by 11% in August and 9.1% in September?

It does not.

Revenues have fallen on a year-on-year basis because of duty cuts and sharp reduction in import values, particularly of oil. Custom and excise duty cuts in petro-products, across-the-board cuts in excise duty to stimulate the economy and a contraction in export due to global slowdown largely explain the fall in indirect tax collections.

The drop in Customs, which account for more than a third of total indirect tax collections, was at 46%, double the drop in excise collections. In June last year, the government cut Custom duty on crude and petroleum products and excise duty on petrol and diesel following the unprecedented surge in global prices. The impact is being felt this fiscal.

Crude import values plummeted along with crude prices as well. Revenues from non-POL products also slid, despite rates being unchanged, due to reduced economic activity in the global and domestic markets, slowdown in exports and a corresponding drop in imported inputs for exports. But the good news is that exports shrank at a lower rate this October and could expand in January 2010. This in turn, could push up imports and Custom collections.

The decline in excise duty collections was on account of the sharp cut in the tax rate from 14% to 8% in two stimulus packages. Revenues slid despite the 6.3% rise in manufacturing output in April-September this year compared to the same period last year. But there has been a modest sequential 4% rise in excise collections in October over September. The problem of revenues leaking away to Cenvat credit claims appears to be much smaller this year. The proportion of Cenvat credit to total excise revenues is lower.

Service tax revenues have fallen 5.5%, partly on account of a 2% cut in the tax rate. Reviving growth should boost service tax collections in the near future.

Manufacturing Sees 200% Rise, In Tax Evasion

Tax department's search and seizure operations have revealed manufacturing to be a big tax evader in 2008-09, just behind the real estate, indicating that the sector may have acquired a bigger play in the black or cash economy. Not just direct taxes, the manufacturing sector has also been on the radar for excise evasion. Excise duties, a tax levied at the factory gate, have not grown at the same rate as the growth in manufacturing. Gems and jewellery, has also seen a sharp increase in the quantum of undisclosed income declared in searches. The searches relate to evasion of direct taxes, mostly unaccounted income.

There was an over 200% jump in undisclosed income admitted to by the manufacturing sector in 2008-09; though in absolute terms it still remained well behind the real estate sector. Real estate sector is always seen as a big generator of black money, as transactions values are often depressed to evade stamp duty. This is largely the reason of evasion cases relates to the real estate sector – 123 in 2008-09.

6.2 **DISCUSSION PAPER**

GST: The Countdown begins

PAIN LESS **TAXATION**

GST will redistribute the burden of taxation equitably between manufacturing & services, bringing about a qualitative change in the tax system. It will broaden the tax base & lower tax rates. The distortions will be reduced fostering a common market across the country. The compliance cost will come down and trade & industry will become competitive, leading to an increase in exports & lower prices for domestic consumers…*Pranab Mukherjee, Finance Minister*

PROPOSED GST MODEL – GST will have two components

1. LEVIED BY THE CENTRE: CENTRAL GST	2. LEVIED BY THE STATE: STATE GST
Will be implemented through one statute for **central GST**	**Will be** implemented through **state-specific law**, but basic feature will not change
Paid into the account of the **Centre**	**Paid into** the account of respective **states**
Administration with the **Centre**	**Administration with** respective **states**

RATES

- **There will** be two rates for GST – a lower rate for necessary items and standard one for others
- **Special rate** for precious metals
- **Services** to have a single rate
- **Exact rates** to be decided later

THRESHOLD LIMIT

- **Rs 10 lakh** gross annual turnover for state GST
- **Central GST** at **Rs 1.5 crore**
- **Services** – **high** but not proposed

MAJOR TAXES THAT WOULD BE SUBSUMED

Central	State
Central excise	VAT/sales tax
Additional excise	Entertainment tax, except those levied by municipal bodies
Service tax	Luxury tax
Additional Custom duty	Taxes on lottery, betting & gambling
Special additional duty on Customs	State cesses & surcharges on goods
Surcharges	Entry tax that is not in lieu of octroi
Cesses	

MAJOR CONSTITUTIONAL CHANGES NEEDED

- **States** will have to get powers to tax services and imports
- **The Centre** will need powers to tax sale of goods

BENEFITS OF GST

- **There will** not be any tax-on-tax, leading to a lower tax liability
- **General lowering** of costs will reduce the cost of goods & services
- **The high** threshold will keep small traders out.

INTER-STATE GST

- There will be inter-state GST, called IGST
- The tax will be levied by the Centre and will be sum of state and central GST
- A scheme of transfer of credit will ensure uninterrupted input credit chain

GST ILLUSTRATION: NO TAX-ON-TAX							
Stage of supply chain	Value of input	Value addition	Value of goods & services at next stage	Rate of GST (%)	GST on output	Input tax credit	Net GST = GST on output – Input tax credit
Manufacturer	100	10	**130**	10	13	10	13 – 10 = 3
Wholesaler	130	20	**150**	10	15	13	15 – 13 = 2
Retailer	150	10	**160**	10	16	15	16 – 15 = 1

SALIENT POINTS

- **The two taxes, state GST and central GST, will be treated Seperately**
- **Input tax credit, or tax paid on inputs, will be allowed only in respect of IGST paid, central or state**
- **Input tax in respect of central GST, for instance, cannot be set off against state GST**
- **Will be applicable on all transactions of goods and services except exempt ones. Those outside GST and transactions below a threshold to keep smaller traders out and for ease of administration**
- **Uniform procedure for collection of both the components**
- **Taxpayers to submit returns to both the central and state authorities**
- **Each taxpayer will get a PAN-linked identification number for GST**
- **Imports would attract both central and state GST**
- **Cross-utilisation of credit between goods & services allowed within one vertical, central or state GST**

Focusing On Core Issues of GST: The much-awaited discussion paper of goods and service tax (GST) in India has been released by the empowered committee of state finance ministers. The proposed GST will have the following key feature:

- Cross-utilisation of input tax credit between CGST and SGST would not be allowed except in case of inter-state transactions (IGST).

The white paper is the first comprehensive document providing clarity on various aspects of proposed GST. One significant innovation that has been introduced in the white paper is the concept of GST. This effectively means that for a supply chain for either goods or services or both that crosses a state boundary, the purchaser would get a credit for taxes paid in the producing state. This is a welcome step to effectively creating a seamless GST that operates on an all-India basis.

However, the white paper has not covered many aspects. For instance, there is no indication on the rate of GST, and the 'place of supply' rules for services. Thus, it emerges that these aspects have not been decided and are still being debated by the policymakers.

In summary, the release of the paper is the first visible and concrete step towards implementing this historic tax reform. Significantly, the paper has been released as the 'first' discussion paper indicating that perhaps additional white papers will be released covering the points discussed above.

That's when things will start to get interesting!

6.3 SECURITY LAWS UPDATES

Sebi Proposes Sweeping Changes

1. **A pure auction method of book-building**

The regulator has mooted a pure auction method of book-building in which institutional bidders would be free to bid at any price above the floor price, and allotment would be on a top-down basis, starting from the highest bidder. Market watchers say this form of bidding helps in better price discovery, as opposed to the current format in which the merchant banker sets a price band and investors have to bid within that range. To begin with, the proposal will be restricted to follow-on public offers (FPOs).

Retail and high net worth investors (HNIs), however, will be allotted shares at the floor price.

In principle, Sebi has decided to allow companies to auction their shares in a FPO to qualified institutional buyers at different prices above the floor, while retail investors will get shares at the floor price. This is a welcome, to the extent it is a precursor to allowing such auctions to discover price in an IPO. After all, for a listed company, there already is a market price whose sanctity is called into question by any other price discovery mechanism. In an IPO, such an auction would prove an efficient way to allocate shares and get the issuer the best average price for its offering and also do away with the mess of over-subscriptions. The trigger for the present guidelines would appear to be the government's need to get the best possible price for its proposed disinvestment in a number of listed companies.

2. **IPO eligibility norms won't apply to SMEs**

Small and medium-sized enterprises, which depend on expansive loans and often informal sources, will now get a chance to list their stocks and raise money from the public. As part of its efforts to encourage SMEs, the Sebi exempted them from the usual eligibility norms applicable for IPOs and FPOs. These norms include a minimum pre-issue networth and profit-making track record.

Also, SMEs will have to disclose their financial results to the exchanges on a half-yearly basis, unlike the larger companies, which have to report their numbers on quarterly basis.

3. **SMEs to list on separate trading platform**:

The regulator has ruled out the need for a separate SME exchange and said stocks can be listed on a separate trading platform of an existing exchange. For companies seeking to list on the SME exchange, the cut-off limit in terms of paid-up capital has been fixed at Rs 25 crore. Companies listed on the SME platform shall compulsorily migrate to an equity exchange/segment on exceeding the Rs 25 crore post-issue paid-up capital limit. Further also, if FPO/Right issue results in triggering of the above limit (of Rs 25 crore) then the company would have to migrate to the main board.

Sebi has proposed a minimum trading lot of Rs 1 lakh for shares in the SME segment, so as to restrict participation to "informed/financially sound/well-researched investors with certain risk-taking ability." For the IPOs, there will have to be a minimum number of investors. However, there shall be no continuing requirement of maintaining the minimum number of investors. Merchant bankers will be required to ensure that the issue is 100% underwritten. However, only a minimum percentage (15%) of the issue size will be mandated to be compulsorily underwritten by the merchant bankers itself. The merchant banker to the issue will bear the responsibility for market-making for a minimum period of three years. It can do so, along with disclosed nominated investors (either private equity fund, high networth individuals or qualified institutional buyers).

During the compulsory market-making period, promoters/acquirers will be allowed to dilute their shareholding only through offer for sale to an acquirer and not to a market maker.

The regulator's move to create a separate trading platform for small and medium enterprises (SMEs) and relax some eligibility norms to help them list is also welcome, as it will help them raise risk capital cheaper than from private equity. However, a minimum IPO application size of Rs 1 lakh and a minimum trading lot of the same size for SMEs make little sense. Had such restrictions been in place, would Infosys have been able to get its IPO through? And would that company have turned millineries out of so many small investors who had the sense to invest in its initial offering? True, small investors might lose their money, making uninformed choices on SMEs. But to protect them against their own poor sense, Sebi is also depriving them of the opportunity to make profitable investments in SMEs on which they have done diligent research. Small investors have the right to make big money from small investments in small companies. Sebi should not deprive them of that right; Even if that right comes paired with the right to lose their money on unwise bets on the stock market.

4. **Half-yearly disclosure of balance-sheet rule**

Market regulator Sebi decision to mandate disclosure of balance sheets by companies on a half-yearly basis is being viewed as a precursor for listed entities to mandatorily disclose their cash flow statements.

Auditors say the move will improve transparency by giving investors a better picture of the financial health of the company. The two half-yearly balance sheets may not be exhaustive compared to the one provided to the investors at the end of the year. But using the two balance sheets, an investor will be able to work out the cash flow details of the company.

5. **Listed or not, governance code for all**

The ministry of corporate affairs is all set to introduce a governance code for unlisted companies on the lines of the one for listed firms to encourage more companies to list on the stock exchange. Elaborate disclosures and compliance with governance code is seen as one big reason why many companies do not want to raise public funds and list on exchanges. The proposed Companies Bill 2009, (now pending with the Parliament Standing Committee), may see unlisted entities being asked to follow specific norms of governance, similar to market regulator Sebi's code on corporate governance for listed companies. Since unlisted companies, at present, have to only follow provisions under the Companies Act which are much less stringent compared to those prescribed by Sebi, many prefer to stay unlisted.

Once unlisted companies, too, are brought into the ambit of a governance code similar to the one existing for listed companies the incentive for staying unlisted would go away. Minister of corporate affairs Salman Khurshid had hinted on the possibility of introducing norms that will remove the regulatory loopholes which unlisted firms tend to use. However, we are conscious that cost of compliance should not become prohibitive for companies from getting them listed. Compliance costs for listed entities includes expenses for carrying out legal formalities, communicating quarterly and annual financial results to stockholders, preparing annual reports and sending them to shareholders, listing fee to the exchanges, and reporting board decisions to the exchanges.

Data shared by the ministry showed that out of over 7 lakh companies in the country, only 6000 are listed on the NSE and/or the BSE.

7.1 INFLATION

Inflation at the Breakfast Table

First it was our lunch and dinner. Now inflation has hit our breakfast. Eggs are selling for four bucks a piece. A glass of milk, dab of butter and a slice of toast already cost 10% more and moving up. What kind of world do we wake up to each morning these days? And how did we get here? The answer lies in two simple words: **conversion cost**. What we pay depends crucially on how much it cost to make. If the cost of inputs spikes, the price of the final product rises too.

Take eggs. To get eggs with the right combination of shell thickness, weight and taste, hens on poultry farms are fed a mix of protein and starch, which come mainly from corn and soyameal. A hen needs to eat 130 gram of this mix to lay an egg. So when the cost of feed rises, eggs become expensive too. The drought has impacted supply of corn and soyameal, raising their prices over 30%. So the new math is simple. An egg now costs a farmer Rs 2-2.25. He sells it for Rs 2.90. The wholesaler sells it for Rs 3. The grocer, the guy actually raking it in, sells it to us for Rs 4.

Milk is the same story. Cows and buffaloes are fed on grain, hay and oil meals. The erratic rains decimated supplies, pushing up feed costs. Bhoosa (hay) used to cost Rs 3 per kilo. Now it costs Rs 6. There is hardly any green grass. If feed crop supply doesn't improve over the next few months, milk prices will rise another 3-4%. But the overall increase in milk prices is still below 14% food inflation.

Bread prices have shot up from Rs 18 per loaf to Rs 20, and manufacturers are now talking of Rs 22. Why? Every 800-gram loaf has 65% wheat flour. Flour prices have increased almost Rs 4 per kilo in the last two months, mainly because private traders don't have much grain. The government-owned Food Corporation if India is the monopoly seller in the market and its higher prices set the benchmark. The other ingredients in a loaf – sugar, milk, oil, salt, soya flour – are all much dearer too. Add higher freight and packaging costs and you know the final outcome.

The same crisis in wheat is hitting breakfast cereals too. Muesli, a favourite amongst the sugar and cholesterol watchers, uses flakes from high-protein varieties such as Madhya Pradesh's sharbati, which is in short supply. Wheat flake prices have risen from Rs 37 a kg to Rs 47 a kg and suppliers want new contracts signed ar Rs 51 a kg, an almost 40% jump. Muesli also uses invert syrup, a pharma-grade sugar syrup, which is now 28% more expansive.

In a nutshell, our crazy breakfast bill is the trickle-down result of the beating Indian crops took at the hands of a terrible summer. Will things improve? In a seasonal business like farming, they usually do.

But this is not the real take away. What is really gob smacking is that we are still eating omelettes and smoothies. Even at these prices. That is the real story. Not one eggs, milk or bread wholesaler is complaining of a decline in demand yet. If anything, the shortage has worsened. India produces about 17 crore eggs daily. There is demand for 19 crore eggs.

Milk and butter prices may be at record highs but customers aren't holding back. The bread market too continues to grow unabated at 15% per annum. At Rs 25 per kilo, bread is still one of the cheapest thing you can eat right now; Ditto in a choice between eggs and vegetables. We are getting used to price levels unheard of earlier. That is a good sign because high prices are the cure for the high prices. Producers crippled by rising inputs and labour costs realise to their amazement they still have a market. The record egg prices will help re-open poultry farms shut due to losses. There has been no capacity expansion there in the last three years. Similarly, farmers will plant more sugarcane, hay and grains.

Even so, bread, milk and eggs are foods that we choose to eat. They are not as critical for our health and survival as dal, roti and subzi. Or so we thought. Not anymore. The Indian consumer remains willing and able to buy them directly or consume them through processed foods without much outcry. Sure, a few families will cut back. But not so you would notice. Our food choices are here to stay.

The crazy price of our breakfast is today's headline. The fact that now we can't do without it is tomorrow's big story. As India becomes wealthier and more nutrition-conscious, our farms will have to work harder to keep pace. That is a huge worry as well as huge opportunity.

Food inflation rises to 13.68%

Higher prices of staple vegetables such as onion and potato pushed food inflation higher to 13.68% in **the last week of October**. On an annual basis, prices of potato have doubled during the one-year period ending October 31, 2009, while onions were expensive by 42.58%. High food prices also pushed up inflation of primary articles (items that are not processed) by 9.16%. Pulses were also dearer by 22.73%.

The government will release the monthly data on WPI-based Inflation, which would reflect price movement in manufacturing, on November 14. However a new comprehensive WPI is likely to replace the current one by the beginning of the new fiscal, as the government expects data collection issues for the wider index to be sorted out by April next year. Abhijit Sen, Planning Commission member and head of the committee that formulated the new wholesale price index said, "There cannot be a new index till there is a reasonable certainty that the data inflow has stabilised. While the earlier index used to source price data from less than 2,000 companies, the new index will be sourcing data from more than 6000 companies. Also we would have the back log of data up to 2004-05 which is the updated base year."

Inflation rises to 1.34% in October

Annual inflation went up sharply in October to 1.34% from 0.5% a month earlier due to costlier food items, the data released on the new monthly wholesale price index released on Saturday (14/11/09). The accelerated inflation is expected to impart more urgency to monetary tightening.

In a new system of reporting wholesale price index (WPI)-based inflation, the entire index will be reported only once a month now against every week earlier. However, the government will continue to report index number for primary articles and fuels every week. This is expected to improve data quality, as more time will be available for collecting and validating data. The base year for the index however, remain 1993-94.

Food inflation rises to 14.6%

Inflation for food items inched up to 14.6% for **the week ended November 7** on account of dearer pulses, vegetables, cereals and dairy products. According to Planning Commission member Abhijit Sen speculation in food items is happening due to two reasons: "While some are speculating that the food items will become dearer as the food management system of the government will fail to deliver, others are counting on a rise in global prices as India enters the international market as a buyer."

Food inflation rises to 15.6%

The annual rate of inflation for food articles, as measured by the wholesale price index (WPI) rose to 15.6% for **the week ended November 14** from the previous week's 14.6%, as price of pulses and vegetables increased sharply during the week. Finance minister Pranab Mukherjee said poor management of supply side by some states had resulted in shortage of some of these items. He sought states' co-operation to deal with the situation.

7.2 WHOLESALE PRICE INDEX

Finally, a more credible price index

The statistics ministry and the office of the economic adviser attached to the commerce and industry ministry finally got their way on October 20 2009 with the Union Cabinet agreeing to allow monthly release of the wholesale price index (WPI), the chief measure of inflation in the country.

As a compromise between those favouring and opposing monthly release of data, it was decided to continue with weekly reporting for two components of the index: primary products and fuel. And, the price data for the manufacturing sector was to be reported on a monthly basis.

A reasonable decision given that weekly data on primary products and fuel group experienced frequent volatility. Also, collecting data for these items is easier; weekly data on primary products is mostly sourced from *mandis*. Similarly, as energy sector is dominated by government-owned companies and prices continue to be largely regulated, getting data of the fuel group is not difficult either.

In contrast, getting regular data flow from the manufacturing sector was difficult. Largely because the office of economic adviser (OEA) depended on voluntary reporting by the manufacturing sector, populated mostly by the private sector, and small and medium enterprises. Many units would not file reports for weeks together, their contention being that there was no change in prices. Of course, there have been instances when price changes were also reported with much lag, affecting the quality of data published. So, it was routine for the OEA to use the last reported data for the purpose of constructing the price index. For the OEA to follow up with manufacturing enterprises on a weekly basis was impossible: it simply did not have the adequate manpower. Thus, it is not surprising that, overall, just about 18-20% of the items in the WPI basket were revised on a weekly basis.

Consequently, the revised data that was published eight weeks after the provisional numbers saw significant changes. Needless to say, often, the provisional numbers looked very different from the revised numbers and sometimes even led to unwarranted policy reaction. The switch over to monthly reporting was delayed due to reservations of the finance ministry as well as the Reserve Bank of India; both responsible for anchoring inflation expectations as well as ensuring sustained economic growth. They felt monthly release of data would delay policy response, especially when prices were rising fast.

It was to improve the quality data and policy response that the statistics ministry and OEA have been pushing for monthly reporting of the WPI data over the past year. Monthly reporting of WPI would have enabled the OEA to capture changes in prices of at least 60% of the items in the basket, as the officials would get enough time to follow up with business. In any case, the norm across the world is to report inflation data on a monthly basis and most countries use consumer price index (CPI) as the primary measure of inflation in the economy.

The real improvement in the quality of data in the sense of capturing price movements in the economy better may become visible only when the government shifts to the new series of WPI along with a change in the base year to 2004-05 from the current 1993-94. This is expected to happen only in the new financial year. Shifting to the new series will mean more items that form the consumption basket will be counted and many items in the current series that have no or low demand would be weeded out. The new series will comprise nearly 1,000 items compared tom 435 in the current series. At the end of the day, the quality of the price index will depend on the response the OEA gets from businesses.

8.1 MISCELLANEOUS UPDATES

Sizing up Buffett's Biggest Bet

Berkshire Hathaway CEO and value investing demigod Warren Buffett has been hinting for some time that he was looking for a large company to buy with Berkshire's huge cash hoard, which stood at about $21 billion at the end of the second quarter. Last year he described his likely targets as "big ones, elephants." On November 3, Buffett bagged a good-sized pachyderm, paying near $34-44billion; including debt – for sole ownership of Fort Worth (Tex.)-based Burlington Northern Santa Fe Corp, the second-largest US railroad.

The deal is the biggest acquisition in Berkshire's history and, in Buffett's words, "an all-in wager on the economic future of the United States." In a statement, Burlington Northern CEO Matthew Rose added: "We admire Warren's leadership philosophy supporting long-term investment that will allow BNSF to focus on the future needs of our railroad." Pending an antitrust review by the Justice Dept. because Berkshire has smaller stakes in other railroad, the deal is expected to close early next year.

Berkshire has been eyeing freight trains for some time. In 2006, the company bought a 10.9% stake in Burlington Northern, later increasing its holding to 22%. On November 3 (Tuesday), Berkshire bought the rest of the company for $100 a share in cash and newly issued Berkshire Hathaway stock. About $16 billion of the purchase price is in cash, half of it coming from Berkshire's coffers and the other half borrowed from banks. The price represents a roughly 30% premium over Burlington Northern's New York Stock Exchange closing price on November 2 (Monday). Berkshire also agreed to assume $10 billion in outstanding Burlington Northern debt.

As with every Buffett move, the deal is being examined for signs and portents about the US economy. Is Buffett signaling confidence in an upturn – or just rebalancing his portfolio? Is Buffett calling a bottom in the recession? Or is Buffett firing the starting gun for a mergers-and-acquisitions resurgence?

The simplest interpretation is that if Buffett – the most ardent devotee of the "intrinsic value" school of equity analysis propounded by his late mentor Ben Graham – thinks Burlington Northern is worth buying now, he simply thinks it's a good business at a cheap price. Burlington Northern's results for the third quarter, which it reported on October 22, showed an earnings decline of roughly 30% - $1.42 per share, compared with $1.99 for the same period in 2008. While the company said it had improved productivity and cut costs, it also noted that this year's third-quarter revenues from carrying freight had dropped $1.28 billion, or 27%, compared with last year.

The question is when might the economy start to perk up and the demand for goods hauled by rail? Buffett has always been fat too canny to publicly make that kind of short-term forecast. He told CNBC on Tuesday that he was confident the US economy would recover, although he had no ides whether it would be this month, this year, or next year. He also said that he had seen no big bounce at any of Berkshire's portfolio companies, although "they might be doing just a tick better" than they were six months ago.

Berkshire's purchase has also widely been interpreted as a bet on coal; About a quarter of Burlington Northern's revenues come from hauling coal along its routes throughout the US, Canada, and Mexico. There are currently 25 coal-fired power plants under construction in the US. Berkshire owns coal plants through its portfolio company MidAmerican Energy, which is not only Iowa's largest utility, but also serves other Midwestern states. The company's CEO, David Sokol, has frequently been mentioned as possible success to Buffett, 79. There's another way to look at the Burlington Northern deal. The purchase represents a move by Buffett to rebalance a portfolio that has become overweighed in stocks with heavy exposure to the financial sector. So the real headline here is 'Buffett Diversifies.'

8.2 INSURANCE SECTOR

India to Infuse Life into Health Plans,

The insurance regulator has proposed a new consolidated health and life cover for over six crore poor families that will replace all existing insurance schemes sponsored by the central and state governments. The Irda plans to provide every poor family a life cover of Rs 1.5 lakh and a medical cover of Rs 1 lakh. An integrated cover will cost Rs 1,500 per annum of which the Centre will bear half the premium and the rest will be shared equally by the states and the beneficiaries.

The proposal, estimated to cost Rs 12,000 crore, will cover most families in the unorganised sector and will replace all other central and state-sponsored insurance scheme. The insurer, who underwrites the policy, will also get a profit, making the scheme commercially viable.

Hari Narayan, chairman of Irda said, “We analysed the risk profile of poor families and families in the unorganised sector. A universal social insurance plan to provide insurance cover to eight crore families in the unorganised sector, which includes six crore families living below poverty line, could be a viable alternative to the plethora of schemes being run now.” The proposal is being examined by the Thirteenth Finance Commission, which is a constitutional body that recommends formula for sharing revenues between the Centre and the states.

In this case, the Centre’s share of the premium works out to around Rs 6,000 crore per annum, and about Rs 30 a month for a poor family. Today, both the Centre and the states spend over Rs 4,000 crore on social insurance schemes with different claim ratios. It is believed that the insurance coverage and costs can be optimized with a well-designed scheme that integrates all the risk covers: health, partial and full disability, and death.

Government-sponsored insurance schemes include the flagship Rashtriya Swasthya Bima Yojna (RSBY) that provides health insurance to poor households and Aam Aadmi Bima Yojana (AABY) that offers death and disability insurance to the unorganised sector.

Irda has analysed efficacy of all domestic insurance schemes and has examined healthcare plans in various countries including UK’s public health system, National Health Service. Universal healthcare systems differ across the world according to the extent of a government’s involvement and the funding model. In the UK, Spain and Nordic countries, the government is involved in a big way in the commissioning or delivery of healthcare services. In the US, on the other hand, healthcare services are largely owned and operated by the private sector.

In India, the decision to adopt the proposed comprehensive social insurance plan will depend on the availability of resources with Centre and the states.

9.1 KNOWLEDGE RESOURCE

National Food Processing Policy

It's the only industry that has managed to remain a "sunrise" one for well over two decades, a total study in contrast to the country's fast-moving and globally recognised IT sector. Little wonder that Prime Minister Manmohan Singh chose to make the latter the benchmark for the growth of the former and the emergence of Indian food processing companies as global brand names.

Addressing the inaugural session of the Conference of State Food Processing ministers, Prime Minister Manmohan Singh said, "I recognise that we need to look at the taxation structure in the industry. Though primary agricultural commodities are mostly exempted from taxes, processed foods are subjected to multiple levies. There is therefore, an urgent need to rationalise and simplify the tax structure." Further, he added, "The food processing industry is fragmented and most of the players are small and unorganised. This poses a special challenge to the development of the industry as a whole. The small scale sector will require hand holding to make them profitable and even competitive in the world market."

The Prime Minister pointed out, "The government was working on optimising private sector investment in the sector through the formulation of a National Food Processing Policy which aims at spelling out measures for the rapid growth of the sector." Further, he said, "Most of India's large industrial houses have a growing presence in the food processing sector. There is no reason why they should not emerge as global brand names just as in our IT industry has done to our great satisfaction."

The Prime Minister said, "I recognise that inadequate infrastructure is a major problem facing this important sector. But the efforts of the flagship Bharat Nirman programme are beginning to be felt on the ground and will I hope transform rural infrastructure in the years to come."

The new policy would also focus on expanding public investment in order to build rural on-farm infrastructure like primary processing centres, collection centres, cold chains etc. The new policy would be comprehensive and adopt a number of legislative, administrative and promotional measures and would shape up on the basis of discussions with the states and industry both in the public and private sector.

The new policy would be aimed, he said, at institutional strengthening and capacity building across the value chain and at promoting the development of viable agri-business and agro industry models across different agri-climactic zones, greater Public-private partnership in technology development under the aegis of the Central Food Technology Research Institute (CFTRI) was also envisaged.

Asserting that the foods processing sector "undoubtedly" had the potential to be an industry driver that can transform India's rural economy, he admitted, however that there were a number of constraints both in the forward and backward linkages in the sector. "But if we can get out act together, as we must, India can emerge as a leader in the global food processing industry."

To achieve the vision for the sector, the government adopted in 2005 a 'Vision 2015 – Strategy and Action Plan,' the PM said, to enhance the level of processing of perishables from 6% to 20%, to increase value addition from 20% to 35% and to increase India's share in global food trade from 2% to 3%.

India ranks first in the production of milk, pulses and tea & second in the production of fruits and vegetables in the world. Despite being a major food producer, though, India's share in world food trade is less than 2%. The level of processing in India is extremely low at around 6% compared to 60-80% in developed countries and over 30% even in most other Asian and Latin American developing countries.

9.2 KNOWLEDGE RESOURCE

UIDAI Pans to Mop up Rs 288 crore yearly

The Unique Identification Authority of India (UIDAI), headed by Infosys cofounder Nandan Nilekani, has drawn up a blueprint that will help it earn Rs 288 crore in annual revenue and offset its long term costs. According to the initial estimates drawn up in the white paper, the authority could mop up this money annually through nominal fees charged for its authentication services.

The authority, likely to be designated as a statutory body soon, has circulated a white paper among key stakeholders with details of revenue income among other aspects. The key stakeholders include banks, which will be able to rope in better quality customers, and various government departments, which want to ensure that allocations reach the target audience.

The UIDAI, a multi-billion dollar project, plans to offer three kinds of authentication services: basic ID confirmation, address verification and biometrics confirmation. While the basic ID confirmation will not be charged for, the authority will charge Rs 5 for every address verified and Rs 10 for every biometrics confirmation. Registrar and service providers will also be able to charge for the cards they issue residents with the UID number. Such pricing will be within UIDAI guidelines.

The white paper said, “The ability of the UIDAI to offer agencies across the country strong, reliable authentication is the key to its sustainability. The UIDAI will offer resident authentication services for a fee to government and private sector firms.”

The customers for these authentication services are expected to be gas connection providers, LIC policy issuers and the Income Tax Department while issuing PAN cards. Agencies spend hundreds of crores annually in verification and this is the opportunity the UIDAI is eyeing. Credit card issuers and banks providing home loans and personal loans also need to carry out background checks and can be potential users of these services.

The services will be subsidised for government agencies. The agencies which request a resident authentication service will have to be registered with the UIDAI and follow strict guidelines in using the service as well as in managing resident information.

The normal process of verifying address is through a physical visit as well as an enquiry to confirm additional information that is provided. This process is expensive and costs between Rs 100 to Rs 500 per verification. UIDAI will offer these services for just Rs 5 per transaction. The agency needing confirmation will just have to submit the UID, name and address of the resident to the Central ID Data Repository (CIDR, the issuer of UID numbers), which will confirm the address. So the agency will not have to undertake physical address verification. The UIDAI will start issuing UIDs in 12-18 months and it plans to cover 600 million people within four years from the start of the project.

Ideas Matter

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