IAS INTERVIEW 2012

[I]

Current Affairs (National & International Issues)

- Reservation in promotion
- GMR- Maldives issue
- FDI in retail
- Doha climate talks
- USA Fiscal Cliff Issue

RESERVATION IN PROMOTION

Why was it in news recently?

The 117th constitutional amendment for reservation in promotions in government for SC/STs was passed in the Rajya Sabha with an overwhelming majority. The bill is pending in Lok Sabha and will be taken up in the next session.

Background

Before understanding the constitutional validity of the issue in question, there are some terms related to promotion that need to be understood first.

The concepts are 1) the roster system 2) the catch up rule and 3) consequential seniority.

1. *The roster system*

Say you have a department of 100 positions. These positions don't open up all at once rather vacancies arise sporadically due to retirement, transfer, promotion, deaths etc. The roster system is the instrument of choice to allocate these vacancies. For example you have a *10-point roster* which might say vacancy 1=Open 2=SC 3=SC 4=Open.. until 10=SC. The roster would then rotate. The key to note is if a reserved vacancy arises it can only be filled by members of that group; if an open vacancy arises it can be filled by anyone including reserved category members.

2. The catch-up rule

Quotas in promotion naturally allow leap-frogging. Consider this: Two candidates A (open) and B (reserved) are in the same class of service Grade 1. Say, A is 5 years senior to B and both are awaiting promotion to the next level i.e Grade 2. B now gets promoted over A due to the roster system. Eventually say after 3 years A also gets the promotion to the same grade as B. What happens now? Under the catch up rule – A will regain his seniority of 5 years over B because he was denied promotion in the first place due to the roster. This means for the open category vacancy in Grade 3 – A has restored his old seniority of 5 years (i.e caught up) over B.

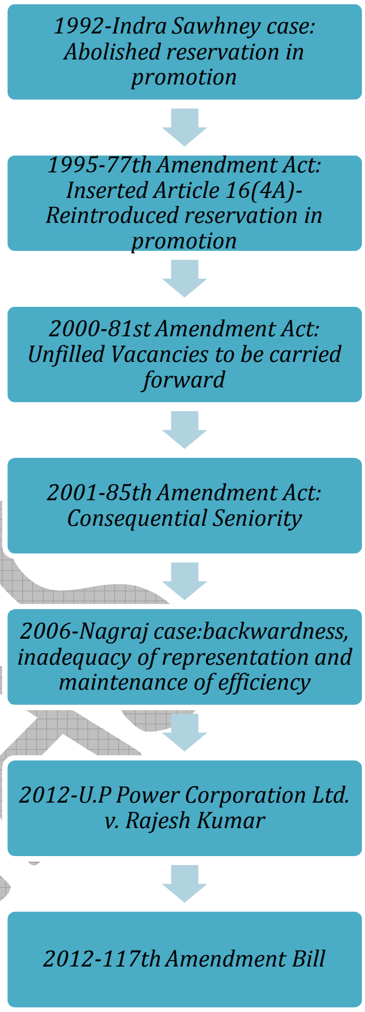
3. Consequential seniority

The exact opposite of the catch up rule above is consequential seniority. In the above case, now A and B are in Grade 2 – B has been there for 3 years and A has recently been promoted. Under consequential seniority, A is now *junior* to B. The fact that he was 5 years senior to B before the roster system leap frogged B is deemed immaterial. For further promotion to Grade 3 – even for open category vacancies as per the roster – A will be considered 3 years junior to B. In other words, he has lost 8 year s*inter se* B.

Cases and Amendments related to reservation in Promotion

The Scheduled Castes and the Scheduled Tribes have been provided reservation in promotions since 1955. However, in 1992, this was discontinued following the judgment in the case of *Indra Sawhney Vs.Union of India*, wherein it was held that it is beyond the mandate of Article 16(4) of the Constitution of India. The political response was swift and the *77th amendment was adopted in 1995 and thus Article 16(4A)* was born which read as: *"Nothing in this article shall prevent the State from making any provision for reservation in matters of promotion to any class or classes of posts in the services under the State in favour of the Scheduled Castes and the Scheduled Tribes which, in the opinion of the State, are not adequately represented in the services under the State.".*

This was followed by a further controversy — the *"carry forward" problem*. Could vacancies in reserved seats be carried forward into future years? Indira Sawhney adopted a halfway house approach to this, holding that carry forwards were permissible but could not exceed 50 per cent of the total vacancies available for posts in the following year. Again, Parliament passed *81st Amendment Act, 2000* which provided that the unfilled vacancies of a year reserved for SC/ST kept for being filled up in a year as per Article 16, shall be considered separately for filling vacancies in the succeeding year and the previous list will not be considered for filling the 50% quota of the respective year.



Next issue that came up was of *consequential seniority*. As it has been seen above that consequential seniority confers a permanent blow to the unreserved candidate. Several states employed a variation of this and the matter came to a 5 judge bench of the Supreme Court in *R.K Sabharwal vs State of Punjab 1995*. The court ruled *consequential seniority* as unconstitutional. This was reaffirmed over the next 5 years in several cases. In 2001 it was brought again to the court in *M.G. Badappananvar vs Karnataka 2001*. Due to consequential seniority general category candidates in Karnataka had retired without due promotions while their juniors were in higher posts. Many still in service at junior levels approached for relief. The court restored the seniority (applied *catch up*) of several general category candidates in this decision. This was totally in accordance with *RK Sabharwal* established 5 years ago.

The political class, this time the NDA government acted fast. They introduced they *85th constitutional amendment* that specifically inserted the word "*promotion with consequential seniority*" in Art 16(4A). The amendment was made *retroactive from 1995 (6 years earlier)* – which means seniority lists could be redone.

In 2006, while upholding the constitutional validity of the amendments, the Supreme Court in *Nagaraj case* made it very clear that Article 16 (4A), which was inserted through these amendments, was only an *enabling provision*. In essence, every time a government or the legislature sought to provide reservation in promotions under Article 16 (4A), it would have to pass constitutional muster. While justifying each attempt to provide reservation in promotions, the state would have to *demonstrate backwardness, inadequacy of representation and maintenance of efficiency.*

At the centre of the current controversy is a judgment delivered by a two-judge bench of the Supreme Court in *U.P Power Corporation Ltd. v. Rajesh Kumar in April 2012*. It had already been held in M. Nagaraj v. Union of India (October 2006) that the state must demonstrate backwardness, inadequacy of representation and maintenance of efficiency before providing reservation in promotions. However, what the U.P Power Corporation did for the first time was to strike down reservation in promotions for not meeting these criteria.

It is important to note scope of the judgment

- The constitutionality of reservations in promotions was not challenged
- The consequential seniority (so called clause 8A in judgment) in UP was not challenged
- The judgment only hinges on the **".. are not adequately represented"**. This sentence in Article 16(4A) requires some homework from the state.

To find the solution of the above problem, government has brought up 117th constitution amendment bill to remove the need to collect data.

117th amendment bill

- The Constitution (One hundred and seventeenth) Amendment Bill, passed in Rajya Sabha seeks to amend Article16(4A) of the constitution to enable the government to provide quotas in promotions for the Scheduled Castes and the Scheduled Tribes who constitute roughly 25 percent of the country's population.
- It seeks to remove the term 'inadequate representation' mentioned in Article 16(4A) to justify quotas in promotions and appointments.
- It also delinks the term 'efficiency of administration' from the claims of SC and ST for jobs and promotions, mentioned in Article 335.
- Article 335 of the Constitution says that the claims of the SC and ST have to be balanced with maintaining efficiency in administration. The bill states the amendment will override the provision of Article 355.
- The Bill provides that all the Scheduled Castes and Scheduled Tribes notified in the constitution shall be deemed to be backward.

Hence, Article 16(4A) after the passage of 117th amendment bill would read as:

"Notwithstanding anything contained elsewhere in the Constitution, the Scheduled Castes and the Scheduled Tribes notified under article 341 and article 342, respectively, shall be deemed to be backward and nothing in this article or in article 335 shall prevent the State from making any provision for reservation in matters of promotions, with consequential seniority, to any class or classes of posts in the services under the State in favour of the Scheduled Castes and the Scheduled Tribes to the extent of the percentage of reservation provided to the Scheduled Castes and the Scheduled Tribes in the services of the State."

Various articles related to the bill are as explained below:

- *Article 341 and 342* of the Constitution of India define as to who would be Scheduled Castes and Scheduled Tribes with respect to any State or Union Territory.
- *Article 335:* The claims of the members of the Scheduled Castes and the Scheduled Tribes shall be taken into consideration, consistently with the maintenance of efficiency of administration, in the making of appointments to services and posts in connection with the affairs of the Union or of a State

Arguments in favour of reservation in promotion

1. *Selection biases inherent in the system*-There are 102 Secretary-level officers in the Government of India today, but just two of Scheduled Tribe (ST) background and not a single one from the Scheduled Castes (SC). Likewise, out of the 113 Additional Secretaries, there are only five SCs and one ST, while among the 434 Joint Secretaries and equivalent officials, these two groups account for just 32 and 14, respectively. SCs and STs together make up almost a quarter of India's population. Yet, when it comes to representation in the bureaucracy, they constitute merely 16.3 per cent of 'Group A' Central employees, which rises to 20.9 per cent in 'B' and 25.1 per cent in 'C' categories. The posts that they really fill up are at the 'Group D' level, comprising peons, attenders, drivers, gardeners, etc.

   Poor ACR are often issued for the SC/ST cadre affecting their promotion prospects. Quotas in promotions would force the selection system to *actively seek out* bright SC/ST persons, who are otherwise not even considered because they do not belong to the right networks.

2. *Important for policy making*: Representation at the top matters because the *neta* and the *babu* are both powerful in India; it is at their levels that policy gets made. Just as only a woman can tell you what being raped or groped means, only a Dalit knows how discrimination works both overtly and subtly.

3. The other debate is regarding *merit based promotions* and whether this bill would rob meritorious persons of their promotions in a bid to make way for the SC/STs? The arguments are that the present concept of merit is designed by the upper castes to exclude the backward classes from their legitimate quota. This was answered a century ago by the Justice Miller Committee. It had said that merit should never be measured only on the basis of academic marks secured in an examination. It should also be based on other traits like honesty, integrity compassion and basic common sense in which it is no body's case that the backward class is anyway inferior to the upper class.

4. Reservation only at the entry level in the lower rungs of service is not enough and hence reservation in promotion will go a long way in achieving the original objective in providing adequate representation qualitatively.

Arguments against reservation in promotion

1*) Loss in efficiency*: In many ways it is the efficiency question that has always been at the heart of the debate concerning reservation in promotions. Reservation in promotion would lead to "loss in efficiency".

2) *Division of Society*: The proposed Constitutional amendment, if made, would only accelerate division in the society on a "promotion-driven caste parameter". "It is a typical case of individual feeling taking shape of a cohesive group feeling. People of one cadre are developing resentment against each other just because they are from a certain caste.

3)*'Reservation in promotion has failed to achieve its objective'*-A look at the data shows that in most of the government departments, the positions meant for SC/STs never got filled despite reservation. For instance, if recruitment pattern between 1971 and 1989 in government department like the UP State Electricity Board was any indication, the people from SC/ST category could not go beyond a mark of 4.1 percent as against the then prevailing 18 percent reservation meant for them. On at least six occasions, in 1977, 1979, 1980, 1981, 1983 and 1985, not a single SC/ST engineer could get recruited despite reservation.

Way Ahead

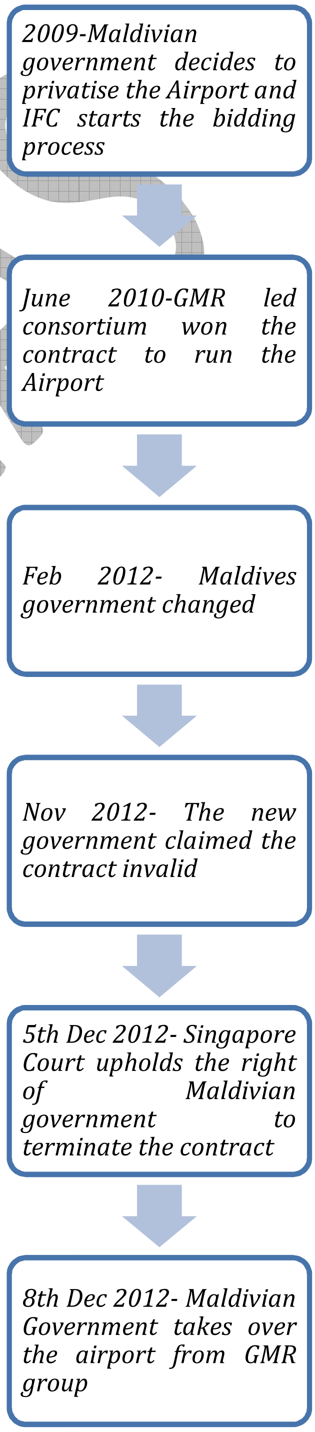
Even if the Bill does go through the Lok Sabha, it is very likely to be challenged in the Supreme Court where it will be tested for violation of the basic structure of the Constitution. The demand to do away with the requirement of 'inadequacy of representation' was specifically debated in the Constituent Assembly and rejected. The Constituent Assembly rejected the demand because it believed it would give the state unacceptable power in terms of determining the beneficiaries in the context of the general equality protection within the Constitution. Removing the requirement to establish inadequate representation of the SCs/STs would certainly make it easier for the state to provide quotas in promotions but it goes against the fundamental principle on which the decision to provide reservation in employment was based. All those clichés about learning from history might come back to haunt this constitutional amendment when the Supreme Court decides upon its validity.

GMR- MALDIVES ISSUE

Why was it in news recently?

On December 8, the Maldivian government took control of the international airport at Male on Hulhule Island from a consortium led by the GMR Group. GMR Group is an infrastructural company headquartered in Bangalore. The company was founded in 1978 by Grandhi Mallikarjuna Rao.

Background



- The Maldives government in 2009 decided to privatise the International Airport at Malé and asked the International Financial Corporation (IFC), the private sector arm of World Bank, to manage the bid process for privatisation of the airport to ensure fairness.
- The bidding process itself was a typical three-stage process. In the stage of request for proposal, the bid was evaluated on three parameters — legal, technical and financial.
- In the first two stages — legal and technical — there was only pass or fail criteria. To evaluate the financial bids, a set formula was given to all the bidders after discussions between the privatisation committee and IFC. The formula was based on the Net Present Value of the revenue (in US Dollars) the bidders will pay to the Maldives government. In other words, the key was who would pay the maximum revenue share to the nation
- In June 2010, the Maldives government, the Maldives Airports Company Limited (MACL) and GMR-MAHB Consortium won the contract and signed a tripartite concession agreement to develop and run the Ibrahim Nasir International Airport at Malé, the capital of the island nation.
- Under the terms of the contract, Maldives had decided to make a passenger service charge a pass through item from the airport. In other words, the sum earlier being earned by the MACL now goes to the government directly. Instead it had allowed GMR to levy an Airport Development Charge (ADC) on the departing passengers, which GMR claims is an international experience.

- However, in February 2012 the Maldives government changed. President Nasheed was replaced by President Waheed in a coup. This government claimed the contract was invalid and terminated GMR's contract to run the airport.

<u>Why did Maldivian government terminate the contract?</u>

Following reasons are supposed to be behind the termination of GMR's contract:

1. *<u>Faulty Process</u>*: According the current Maldives government the technical evaluation process that followed did not qualify GMR for the project. But the technical evaluation committee acted under pressure from the then president (Mohamed Nasheed) and qualified the GMR Group for the project. The then president surreptitiously signed the deal with GMR even as Parliament cleared a Bill which mandated that every case of large-scale foreign investment needed to go through it (Parliament). The then president had the GMR deal signed before giving his assent to this Bill. Thus, what the then president signed (with GMR) was an illegal contract.

2. *<u>Low revenue share</u>*: When the deal was signed between the government and the GMR-led consortium, the government gave them the entire island of Hulhule and the vast real estate for commercial exploitation. GMR was also allowed to raise rentals to leaseholders. But the commitment from the GMR side was to share just one per cent of the airport revenue with MACL for the first 10 years, and 10 per cent of the revenues for 15 years thereafter, which was very low. It was not seen as a fair deal at all. The contract was not acceptable to the public.

3. *<u>Airport Development Charge (ADC)</u>*: One of the clauses introduced in the contract that MACL signed with GMR was to collect a $25 airport development charge (ADC) from every departing passenger. The law of the land is clear that no taxes of any type can be levied on anybody in the country without the approval of Parliament. ADC could have been legalised had the country's Majlis approved such a charge. Before this could happen, the government changed in the coup and the ADC was later turned illegal by a local court.

   The other issue was that there was already an ADC of $20 per passenger introduced by the previous president on tourists, called Tourism Goods & Services Tax. That meant an outgoing passenger had to pay $45 every trip. As tourism is the lifeline of country, and costs such as these could destroy tourism economy.

   In the absence of such a charge the earlier government had allowed GMR to deduct the ADC revenues from the revenue share of the government. Due to this offset, the government has to pay $3.5 million to GMR for the current calender year period till November.

   This charge has got caught up in the national legislature which projected that MACL can instead earn a $4 billion in the term of the concession period ie till the year 2035. But with GMR running the airport the revenue share for the nation will amount to $1. 4 billion. Against this argument, GMR has projected that Maldives will earn $2.1 billion. To buttress its point, the current government questioned the levy of the ADC as part of the revenue share model and moved to cancel the contract.

Impact on India-Maldives Relations

- Though it's "inevitable" for the move to "affect bilateral relations", India has hoped that the controversy would not be "allowed to be used" by fringe groups in that country to lead to deterioration in ties.
- Foreign minister Salman Khurshid has stated that with GMR Infrastructure reaching a settlement with the Maldives government, the Indian government would not intervene in the matter.
- While New Delhi has been assured by the Maldivian government about the safety of Indians in the island country, India feels that the attitude of the Mohammad Waheed government will work as a deterrent for potential Indian and international investors.

Lessons Learnt

The recent termination of GMR's contract by the Government of Maldives has once again highlighted issues of propriety and legality of the conduct of sovereign parties to a contract in their dealing with foreign investors. Plenty of Indian companies now have a large global footprint and similar issues are bound to crop up periodically.

Very often, states, and particularly developing countries, require capital and technical expertise from nationals of other states. States enter into concession or other agreements for development of their natural resources or infrastructure by foreign investors.

However, many a time, states have repudiated their contractual obligations, "expropriated" the foreign investor's property or otherwise caused diminution in the value of such property. The question then is, how does the investor recover its investments and the projected returns?

The investor may consider certain precautions at the stage of negotiating and concluding the agreement. Some of these precautions are:

- Bilateral investment treaties are a defence against arbitrary state action
- Diligence on the state's assets by the investor before entering into a private contract.
- Make provision for a neutral dispute resolution mechanism with the seat of arbitration outside the territory of the host country.
- Appropriate investment backing, for example, through Multilateral Investment Guarantee Agency

FDI IN RETAIL

Why was it in news recently?

On 7 December 2012, the Government of India allowed 51% FDI in multi-brand retail in India. The government managed to get the approval of multi-brand retail in the parliament despite heavy uproar from the opposition. Earlier in January 2012, India approved reforms for single-brand stores welcoming anyone in the world to innovate in Indian retail market with 100% ownership. FDI in cash and carry wholesale trading was first permitted, to the extent of 100%, under the Government approval route, in 1997.

Retail Market in India

Retailing in India is one of the pillars of its economy and accounts for 14 to 15 percent of its GDP. The Indian retail market is estimated to be US$ 450 billion and one of the top five retail markets in the world by economic value. India is one of the fastest growing retail market in the world, with 1.2 billion people.

Limitations of the present setup

1. *Supply Chain Problems*

There has been a lack of investment in the logistics of the retail chain, leading to an inefficient market mechanism. Though India is the second largest producer of fruits and vegetables (about 180 million MT), it has a very limited integrated cold-chain infrastructure. Lack of adequate storage facilities cause heavy losses to farmers in terms of wastage in quality and quantity of produce in general, and of fruits and vegetables in particular. Post-harvest losses of farm produce, especially of fruits, vegetables and other perishables, have been estimated to be over Rs. 1 trillion per annum, 57 per cent of which is due to avoidable wastage and the rest due to avoidable costs of storage and commissions'' As per some industry estimates, 25-30% of fruits and vegetables and 5-7% of food grains in India are wasted.

2. *Intermediaries*

Intermediaries dominate the value chain. They often flout mandi norms and their pricing lacks transparency. Wholesale regulated markets, governed by State APMC Acts, have developed a monopolistic and non-transparent character. The study shows that the average price that the farmer receives for a typical horticulture product is only 12-15 per cent of the price the consumer pays at a retail outlet. Moreover, today's intermediaries between producers and consumers add no value to the products, but add immensely to final costs. By the time the products travel from the farm-gate to the marketplace via various intermediaries reduces, they lose freshness and quality resulting in huge wastage. Nevertheless, intermediaries reap huge profits by spreading wastage losses between producers and consumers. This is achieved by buying products at low prices from producers, but selling at highly marked-up prices to consumers. In an unsound system with multiple intermediaries simply for logistics, only intermediaries benefit.

With organised retail, every intermediate stage – procurement, processing, transport and delivery – adds value to the product. This happens because it uses global best practices and modern technology, ensuring optimum efficiency and minimum wastage. Organised retail enables on-site processing of produce, scientific handling and quick transport through cold storage chains to the final consumer. Once modern retailers introduce an organised model, other vendors, including small retailers, would automatically copy this model to improve efficiencies, boost margins and stay in business. Organised retail would thereby bring more stability to prices, unlike the present system where hoarding and artificial shortages by profiteering intermediaries push up product prices.

3. *Efficacy of PDS*

There is a big question mark on the efficacy of the public procurement and PDS set-up and the bill on food subsidies is rising. In spite of such heavy subsidies, overall food based inflation has been a matter of great concern. The absence of a 'farm-to-fork' retail supply system has led to the ultimate customers paying a premium for shortages and a charge for wastages.

4. *MSME Sector*

The MSME sector has also suffered due to lack of branding and lack of avenues to reach out to the vast world markets. This has largely been due to the inability of this sector to access latest technology and improve its marketing interface.

Rationale for FDI in retail trading

1. The Agriculture sector needs well-functioning markets to drive growth, employment and economic prosperity in rural areas of the country. Further, in order to provide dynamism and efficiency in the marketing system, large investments are required for the development of post-harvest and cold-chain infrastructure nearer to the farmers' field. FDI in front end retailing is imperative to fund this investment.
2. Investment in organized retail by domestic players will be ineffectively deployed if FDI is delayed. International retailers should be mandated to bring with them technology and management know-how which will ensure that investment in organized retail works to India's advantage.
3. In order to provide dynamism and efficiency in the marketing system, large investments are required for organized retailing, linked with the back end of the value chain. FDI in front-end retailing is imperative to derive full advantage of the value chain for the producer and the consumer
4. There is a need to ensure that issues of cost and quality, relating to consumers, are adequately addressed. This could be achieved through stabilizing prices and reducing inflation, which, in turn, could be achieved through direct buying from farmers, improving supply chain inefficiencies to lower transit losses, improved storage capabilities to control supply j demand imbalances, better quality and safety standards through farmer development and increased processing of produce.

5. Similarly, there is a need to address issues relating to farmers, through removal of structural inefficiencies. This could be achieved through liberalized markets, with direct marketing and contract farming programmes, from which farmers could profit, as also more predictable farm-gate prices, steadier incomes and better access to evolving consumer preferences through private investors, especially the organized retail sector.
6. There is also a need to improve post-harvest management, which could be achieved through investments in supply chains and cold storage to minimize losses and improving processing, as also value addition for better farm incomes.
7. Further, there is a need for yield improvement, which could be achieved through use of contract farming to disseminate technological know-how, working with farmers to promote awareness about soil quality, pesticides and fertilizer usage, grading, sorting capabilities and increasing availability of low interest credit for farmers.
8. FDI in retail, may, therefore, be an efficient means of addressing the concerns of farmers and consumers, as referred to above. The private sector, especially organized retail, is best suited to make investments of this magnitude.
9. Permitting foreign investment in food-based retailing is likely to ensure adequate flow of capital into the country & its productive use, in a manner likely to promote the welfare of all sections of society, particularly farmers and consumers.

<u>Arguments against FDI in retail</u>

1. Move will lead to large-scale job losses. International experience shows supermarkets invariably displace small retailers. Small retail has virtually been wiped out in developed countries like the US and in Europe. South East Asian countries had to impose stringent zoning and licensing regulations to restrict growth of supermarkets after small retailers were getting displaced. India has the highest shopping density in the world with 11 shops per 1,000 people. It has 1.2 crore shops employing over 4 crore people; 95% of these are small shops run by self-employed people
2. Global retail giants will resort to predatory pricing to create monopoly/oligopoly. This can result in essentials, including food supplies, being controlled by foreign organizations.
3. Fragmented markets give larger options to consumers. Consolidated markets make the consumer captive. Allowing foreign players with deep pockets leads to consolidation. International retail does not create additional markets, it merely displaces existing markets.
4. Jobs in the manufacturing sector will be lost because structured international retail makes purchases internationally and not from domestic sources. This has been the experience of most countries which have allowed FDI in retail.
5. Argument that only foreign players can create the supply chain for farm produce is bogus. International retail players have no role in building roads or generating power. They are only required to create storage facilities and cold chains. This could be done by governments in India.
6. Comparison between India and China is misplaced. China is predominantly a manufacturing economy. It's the largest supplier to Wal-Mart and other international majors. It obviously cannot

say no to these chains opening stores in China when it is a global supplier to them. India in contrast will lose both manufacturing and services jobs.

Experience of FDI in retail trade in other countries

1. ***China***

- While the experience of China has been cited by many as an argument for opening India's sector, there are, however, at least two key differences in the organisation of China's retail and in its opening process that are markedly different from the Indian context.
    - ✓ For one, unorganised retail — the sector that stands to be affected the most — has a much larger presence in India.
    - ✓ The second crucial difference is that China gradually opened the sector, giving local chains enough time and protection to learn to compete with foreign entrants. China first allowed 26 per cent FDI in 1992, and expanded this to 51 per cent — what India has allowed — only 12 years later.
- FDI in retail in China, did not lead to closure of Mom-and-Pop stores. China's experience indicates that both organised retail as well as Mom-and-Pop stores can co-exist. China first allowed FDI in retail in 1992, capping it at 26 per cent, while India capped FDI in single-brand retail at 26 per cent. Only in 2004 did China permit 100 per cent FDI. Since then, Chinese Mom-and-Pop stores have grown from 1.9 million to more than 2.5 million. Conversely, organised retail has just 20 per cent penetration, despite operating there for almost 20 years.

2. ***Japan***

- Japan, which registered retail sales of more than $1,500 billion, has legislation to protect small and medium stores from the impact of large stores. Small traders comprise a large portion of the Liberal Democratic Party's support base.
- In 1973, Yasuhiro Nakasone, then the Trade Minister, assured them that the government would "nurture" small and medium-sized companies and "increase resistance" to foreign capital. He introduced a new large stores law that gave powers to local authorities to regulate retail outlets sized between 500 and 1,500 square metres. The authorities could insist on changing the size of the store, working hours and even the number of holidays in deference to small stores.
- American companies such as Kodak and Toys "R" US, which were trying to enter the Japanese market, found these regulations stifling. The U.S. government, through the U.S.-Japan Structural Impediments Initiative, put pressure on their behalf and even took the matter to the WTO in 1995. Buckling under pressure, the Japanese government repealed the large stores law.
- The gates open, upwards of $1 billion of American investments flowed in — but not without consequences. Between 1997 and 2004, the number of large stores grew at the rate of about 3 per cent on average.
- In 2007, the government revised three pieces of legislation — the City Planning Law, the Large-scale Retail Location Law and the City Centre Revitalization Act — to control the expansion of large-scale stores. The country had come full circle in about 10 years. In today's Japan, small

stores exist alongside big stores, not because of a benign large store culture but due to government regulations.

<u>Lesson learnt</u>: Though these countries have opened their retail market to foreigners, they have put regulations on size, location, working hours, pricing and other aspects of large retailers to balance everyone's interest especially that of small retailers.

<u>India's Approach</u>

To protect the interest of small traders India too has included certain preconditions:

- One of the crucial norms in the formal proposal for permitting FDI is that 50 per cent investment will be mandatory in back-end infrastructure, which includes cold storage chains and warehousing.
- The minimum FDI investment would have to be $100 million.
- Retail stores would only be allowed in cities with more than one million people.
- Front-end operations would be allowed only in States that agree to permit FDI in multi-brand retail.
- It will also be mandatory for retailers to source minimum 30 per cent of the value of manufactured goods, barring food products, from small and medium enterprises.

<u>Conclusion</u>

FDI is neither an evil in itself nor a boon in every form. The case for it depends on its actual impact, and that in turn will depend on the choice of field, the amount of money that might come this way, and how it would influence the priorities of economic policies in India. It is not a question of having some abstract principle of "no FDI" — nor one of "any FDI of any kind, anywhere," irrespective of the impact of any particular FDI on the lives of the people involved. When there are both arguments that are "pro" and some that are "con" about a particular policy change, a good policymaker has to take into account both kinds of effects and evaluate whether the overall impact benefits or harms the Indian people.

As of now it can be hoped that the preconditions will serve as sufficient safeguards for small retailers and it will be a win-win situation for all. Ultimately, farmers and small producers will benefit from better prices for their products and produce, while consumers will receive quality products at lower prices along with better service.

DOHA CLIMATE CHANGE CONFERENCE

Why was it in news?

Global climate change regime evolved out of the Earth Summit of 1992, which gave birth to three conventions including the United Nations Framework Convention on Climate Change (UNFCCC). Parties to the Convention have met eighteen times since its creation and the latest round of talks i.e COP-18 were held in Doha from 26 November till 8 December, 2012.

Conference focus

The conference focused on five aspects of climate change:

1. *Adaptation –* social and other changes that must be undertaken to successfully adapt to climate change.
2. *Finance* – how countries will finance adaptation to and mitigation of climate change, whether from public or private sources.
3. *Mitigation* – steps and actions that the countries of the world can take to mitigate the effects of climate change.
4. *Technology* – the technologies that are needed to adapt or mitigate climate change and ways in which developed countries can support developing countries in adopting them.
5. *Loss and damage* – first articulated at the 2012 conference and in part based on the agreement that was signed at the 2010 United Nations Climate Change Conference in Cancun. It introduces the principle that countries vulnerable to the effects of climate change may be financially compensated in future by countries that fail to curb their carbon emissions.

Key Doha COP18 outcomes

1. *Extension of the Kyoto Protocol* – An eight year extension of the Kyoto Protocol until 2020 limited in scope to only 15% of the global carbon dioxide emissions due to the lack of participation of Canada, Japan, Russia, Belarus, Ukraine, New Zealand and the United States and due to the fact that developing countries like China (the world's largest emitter), India and Brazil are not subject to any emissions reductions under the Kyoto Protocol.
2. *Concept of "loss and damage" from climate change*: Recognizing increasingly frequent extreme weather events, as well as slower-acting threats like drought and sea level rise, delegates adopted language urging more financial and technical support for the most vulnerable countries. This concept was formalized for the first time in the conference documents.
3. *Global atmospheric temperature stabilization target*: Participants noted with "grave concern" the widening gap between what countries have promised to do to reduce emissions and the growing concentration of greenhouse gases (GHGs) in the atmosphere. They declared it unlikely that on the current path the world would be able to keep global temperatures from rising more

than two degrees Celsius (3.6 degrees Fahrenheit) from pre-industrial times, a central goal of the United Nations process. Countries stated an intention to "identify and explore in 2013 options for a range of actions to close the pre-2020 ambition gap."

4. *Finance-*Several developed countries – including Britain, France, Germany, Denmark and Switzerland – made pledges to provide a total of nearly €7 billion in "climate finance" over the next two years.
5. *Technology-*The "technology mechanism" of the UN Framework Convention on Climate Change has become fully operational, with a Climate Technology Centre to be set up to help developing countries.
6. *REDD+-*Work on "REDD+", a programme to reduce emissions from deforestation, is to be finalised at the next UN climate change conference in Warsaw towards the end of 2013.

Major gains from the meet

1. *Second Commitment Period-* For starters, a major gain was the acceptance of the developed countries to enter into a second commitment period for reduction of emission of Greenhouse Gases (GHGs) starting from 2013 and ending in 2020.
   The aim of many of the developed countries was for COP18 to give a clean burial to the Protocol and instead await the adoption of a new global compact that would rope in the BASIC. The new agreement on which work is supposed to be completed by 2015 would take effect from 2020, and with its adoption the Kyoto Protocol would come to a natural end. Therefore, the game plan of the developed countries was to make the Protocol inoperative by not extending it over a second commitment period starting from 2013, and thus avoid any further obligation to reduce their emission of GHGs till 2020. Developing countries, particularly India and China, had put much insistence on the continuation of the Protocol and made this a condition precedent to their acceptance of emission intensity reductions and entering into a common global compact. With this divergence between the developed and developing countries, a big gap of eight years starting from 2013 (during which the world will have to do without any fetters being put on anyone on their releases of GHS and thereby resulting in greater global warming stood) out as a distinct possibility.
   Therefore, the agreement at Doha to extend the Kyoto Protocol over a second commitment period for eight years was not an insignificant gain, either to the developing countries or to the Climate Secretariat or to the hosts of the meet or to global climate security.
2. *Carbon Credit-*The second gain for the existing climate change regime was over the issue of continuing the validity of carbon credits (called Assigned Amount Units or AAUs) that had accrued to the Russian Federation and other countries of Eastern Europe under the Kyoto Protocol. The accrual of this huge cache of credits resulted from the closure of a large number of state-owned industrial enterprises in the former command economies, and not through any special efforts on their part to reduce their GHG emissions.
   This whopping asset of almost 13 billion carbon credits that could be transferred to any other country governed by Kyoto Protocol to reduce the latter's emission reduction obligations for a

monetary consideration was sought to be carried over to the Second Commitment Period by Russia and other countries of eastern Europe, notably Poland. This sale of "hot air" would have helped the transferor to earn money and at the same time helped the transferee to meet any reduction obligations under the second commitment without much domestic effort. Worse, the transaction would have negated any gains the Protocol sought to achieve in the second period. As things turned out, in the decision taken at Doha, only a part of these credits was allowed to be carried over to the second period. Thus an issue that had the potential of wrecking the Conference was sorted out successfully.

3. *Financial Mechanism*-The third and perhaps an important gain for India was the renewed commitment by developed countries to contribute to the Green Climate Fund, which would provide financial assistance to the developing countries to meet the costs of implementing their climate mitigation and adaptation efforts. Similarly, a strong commitment was expressed to facilitate transfer of mitigation and adaptation related technologies to developing countries, which addresses the issue of Intellectual Property Rights that often come in the way of such transfers.
4. *It's no longer just about "Carbon"-* Loss and damage insurance, green infrastructure, sustainable development, amongst others, is the new buzzwords in the climate market. The market understands and definition of mitigation and adaptation activities has certainly broadened. Carbon is emerging as a common tool of measurement across various new schemes driven by developmental and energy security factors.

Conflicts and Issues

1. *Developed vs Developing*: The conflict in paradigms between the developed and developing countries was evident throughout the two weeks of Doha climate talks. The longstanding and cardinal principle of the Convention i.e. Common and Differentiated Responsibilities and Respective Capabilities (CBDR) was challenged by a few developed countries. The final text that came out lacked mention of this and even reference to Rio+20 that endorsed this principle was removed on the insistence of the USA.
2. *Kyoto Protocol*-The original Kyoto Protocol Parties i.e. Russia, Japan and New Zealand have decided not to join the Second Commitment period and Canada has left the Protocol altogether. This means that only Europe, Norway, Switzerland, Australia and a few others that totals 35 developed countries and countries with economies in transition have agreed to legally binding commitments in the Second Commitment Period.

> *"...frustration is a renewable resource, but frustration does not reduce emissions"*
>
> Connie Hedegaard,
>
> EU's Commissioner for Climate

3. *Target*-In terms of ambition, the figures are far from satisfactory. The aggregate emission reductions that have been agreed are only 18% below the 1990 level, compared to 25-40 % reduction in emissions required to restrict global temperature rise to 2 degree Celsius. However, one caveat put

forward by developing countries is the “ambition mechanism” through which the countries will revisit their original targets and increase their commitments by 2014, in line with the aggregate goal of 25-40 % reduction.

4. *Carbon Credits*- The countries who have managed to reduce their emissions more than their targets will not be allowed to use their surplus Assigned Amount Units (AAUs) or carbon credits accumulated in the First Commitment Period to be used or traded in the Second Commitment Period as a means to avoid current emission cuts.
5. *Financing*- Another criticism of Doha is lack of means for implementation i.e. financing as per commitment of the developed countries to be provided to the developing countries for taking meaningful actions towards mitigation, adaptation, technology transfer and capacity building.

India and COP18

From India’s perspective, five positive developments from Doha conference are:

1. Formal adoption of the Second Commitment Period of the Kyoto Protocol and continued access to the market mechanisms i.e. Clean Development Mechanism (CDM)
2. Financing for the particularly vulnerable countries for the formulation and implementation of National Adaptation Plans. Previously this funding was limited to the Small Island Development States (SIDs) and Least Developed Countries (LDCs)
3. Development of an international mechanism to address loss and damage. This mechanism would support countries that are impacted by slow onset events like droughts, glacial melting and sea level rise
4. A new work program to build capacity through climate change education and training, create public awareness and enable the public to participate in climate change decision making and
5. Language in the text regarding technology needs assessment and that no unilateral measures will be taken relating to the development and transfer of technology in the developing countries.

The path forward

Only future would determine the ultimate conclusion of this prolonged dialogue between the developed and developing countries given the global economic crisis but one thing is certain that climate change is not waiting for that moment. Recent incidents in a number of countries where the frequency and intensity of extreme events have increased are a testimony to the fact that climate change is happening and it’s happening now.

In 2013, climate change will be strongly on the agenda, as businesses and governments develop more pro-active strategies to mitigate risks and improve resilience to extreme weather events. Further, the UNFCCC process will continue to progress slowly toward a "global deal" in 2015.

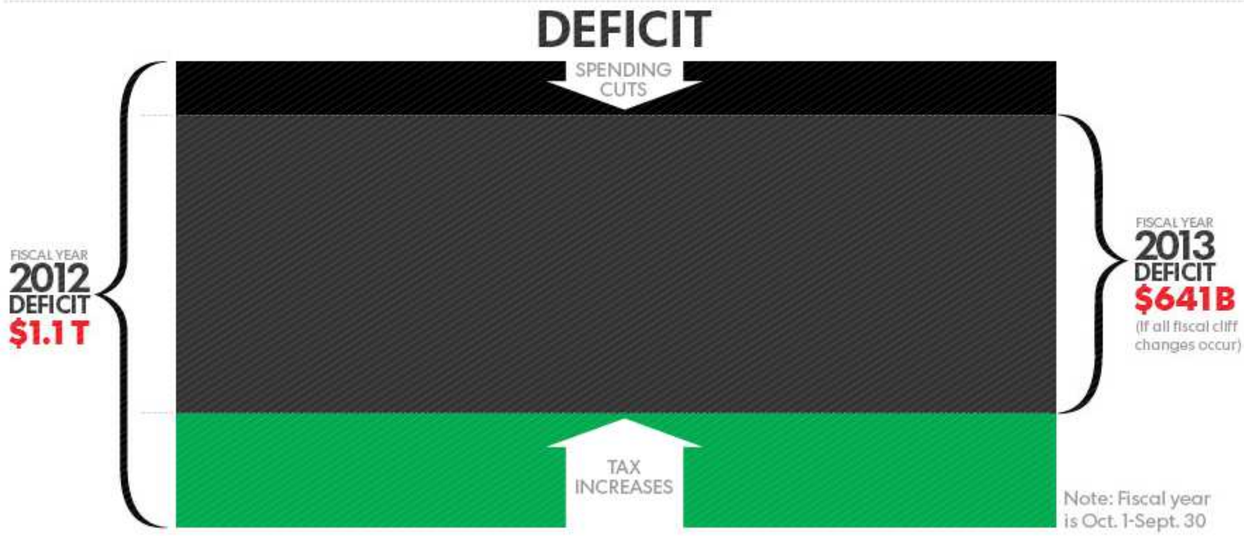
USA's FISCAL CLIFF ISSUE

Why was it in news?

USA is grappling with the issue of "fiscal cliff" and to avert the risks associated with the issue it passed the *American Taxpayer Relief Act of 2012* on 1st January 2013 that would allow tax rates to rise only on wealthiest Americans while temporarily suspending spending cuts.

Understanding the Fiscal Cliff

The "fiscal cliff" refers to "a raft of tax and spending changes that were scheduled to take effect from 1st January, 2013 that would have sharply reduced the federal budget deficit but could have also sent the economy back into recession, if they all had happened at once".



The following set of revenue and spending measures were set to expire or take effect at year's end, representing an acute fiscal consolidation that could be further intensified by a potential showdown over the debt ceiling.

Revenue Increases/Tax Hikes

- **2001/2003/2010 Tax Cuts & AMT Patch.** This series of legislation, often referred to collectively as the "Bush tax cuts," expired on December 31, 2012, raising all income tax rates (top will go from 35 to 39.6 percent), as well as rates on estate and capital gains taxes. The alternative minimum tax (AMT) also automatically applied to millions more citizens.
- **Payroll Tax Cut.** The Social Security payroll tax holiday expired on December 31, raising the rate from 4.2 to 6.2 percent.
- **Other Provisions.** Several other policies such as the Research and Experimentation tax credit, many of which are typically enacted retroactively, expired at years' end.
- **Affordable Care Act Taxes.** Some provisions in the Obama health-care legislation, including increased tax rates on high-income earners, were set to take effect in January 2013.

Spending Cuts

- **Budget Control Act.** The automatic spending cuts or sequester legislated by the Budget Control Act of 2011 hit January 2. Half of the scheduled annual cuts ($109 billion/year from 2013-2021) came directly from the national defense budget, half from non-defense.
- **Extended Unemployment Benefits.** The eligibility to begin receiving federal unemployment benefits, last extended in February, expired at year's end.
- **Medicare "Doc Fix."** The rates at which Medicare pays physicians decreased nearly 30 percent on December 31.

Understanding the macroeconomics behind "Fiscal Cliff"

Basic macroeconomics holds that increased taxes and reduced government spending, whether individually or in combination, would depress the economy. This is because higher taxes means less money left in people's pockets to spend, thereby lowering consumer demands for the economy's goods and services, which in turn would induce production cutbacks. Lower spending by government similarly dampens demand and reduces overall production. Doing the reverse would stimulate more economic activity. Indeed, this was the original rationale for Bush's tax cuts and Obama's "fiscal stimulus" government spending, both of which were time-bound, being extraordinary measures taken then.

How did US come to this situation?

The fiscal cliff is in many ways the culmination of a series of increasingly contentious fiscal showdowns between the Democratic and Republican parties over the last few years. The most noteworthy, the debt-ceiling fight of August 2011, threatened the country's ability to meet its financial obligations and resulted in an unprecedented downgrade in the U.S. credit rating by Standard and Poor's. The subsequent failure of the bipartisan supercommittee to reach a deal on $1.2 trillion in targeted budget savings over ten years unleashed automatic spending cuts for both defense and non-defense spending.

Most critics believe that the lack of a comprehensive, long-term deal on deficit reduction—one that addresses the need for major tax and entitlement reform—has propelled the use of short-term political expedients like the "doc fix" and other extenders. Meanwhile, the nation's debt soars on an unsustainable path, according to most projections.

Taxes and the role of government lie at the heart of the debate. Generally speaking, Republicans favor spending cuts as a primary means to achieve deficit reduction. Most have also publicly pledged to oppose all tax hikes, suggesting, rather, that tax cuts boost economic growth and, in turn, government revenue. Democrats typically believe tax increases should be part of any bargain to reduce long-term entitlement spending, and have generally supported greater reductions in the defence budget.

This philosophical rift was on display in the debate over the fiscal cliff. In particular, the two parties were divided over how to extend the Bush-era tax cuts, the largest single component of the fiscal cliff.

Republicans were pushing for all cuts to be extended, while many Democrats, led by President Obama, wanted to extend all cuts except for the wealthiest 2 percent of taxpayers.

The fight over taxes is also very much part of the sequester debate, with Democrats pushing for more revenue as part of any deal to avert the drastic mandatory cuts.

<u>What would have been the domestic consequences?</u>

The impending tax increases cum spending cuts represent more than $600 billion of combined reduction in consumer and government spending, not counting the multiplier effects that would further magnify the resulting drop in US gross domestic product (GDP). With consumer and government spending together accounting for 90 percent of overall US GDP, this would push their economy into a steep fall (as in falling off a cliff) and yet another round of recession. Estimates place the expected drop in US GDP to be induced by reduced consumer and government spending at no less than 4 percent.

<u>What would have been the global consequences?</u>

The repercussions abroad would likely be significant. An October 2012 IMF report notes that massive fiscal tightening in the United States in early 2013 is a primary risk to global economic stability. Protracted gridlock in Washington would stall the U.S. recovery with deleterious spillovers to the rest of the world. In addition, delays in raising the federal debt ceiling could increase risks of financial market disruptions and a loss in consumer and business confidence.

<u>US fiscal cliff deal</u>

On 1st January 2013, U.S. Senate approved last minute deal on 'fiscal cliff'. The Senate passed a compromise bill, the *<u>American Taxpayer Relief Act of 2012</u>* that would allow tax rates to rise only on wealthiest Americans while temporarily suspending spending cuts.

Some of the important provisions of the act are as follows:

- The budget sequestration was delayed by two months, to give time for further negotiations on deficit reduction.
- Marginal income and capital gains tax rates increased relative to their 2012 levels for those with annual income over $400,000 for individuals and $450,000 for couples, but the rates below these levels remained at their 2012 levels. The top income rate increased from 35% to 39.6%, and the capital gains rate increased from 15% to 20%.
- A phase-out of tax deductions and credits for incomes over $250,000 for individuals and $300,000 for couples was reinstated.
- Changes were made to the alternative minimum tax to index it to inflation, to avoid its application to middle-class families.
- The two-year old cut to payroll taxes was allowed to expire.

It was welcome news that the US Congress reached a compromise agreement to avert falling off the cliff on Jan. 1—and surging stock markets all over the world reflected a collective sigh of relief. And yet, all that was really achieved was yet another Band-Aid solution that pushed back the day of reckoning anew.

The deal only addresses one side of the issue that is tax hikes while delaying the spending cuts. More permanent solutions have yet to be agreed upon, and there are wide disagreements between Democrats and Republicans on the issue. In fact, the compromise solution does not avoid pain altogether; it simply turned the cliff into a downhill slope.

Way Ahead

Policymakers should forge a credible plan to impose a requisite amount of medium to long-term fiscal consolidation that will stabilize the federal debt. Medium-term consolidation will need to include a reform of entitlements, the key driver of long-term spending, but must also raise revenue, given the size of the deficit and the relatively low tax ratio.

The sooner such a plan can be worked out, the better, say analysts. Failure to make the hard but necessary choices now on our own terms will lead to much harder and more severe choices later. Continuing to grow the debt at unsustainable levels threatens to trigger a sharp increase in U.S. borrowing costs and further downgrades to the nation's credit rating.

While global investors may continue to fund high U.S. deficits for several more years, recent experiences of several advanced economies in Europe indicate the unpredictability and speed at which fiscal crises can come.

