

Gist of EPW January Week 2, 2023

The Economic and Political Weekly (EPW) is an important source of study material for [IAS](#), especially for the current affairs segment. In this section, we give you the gist of the EPW magazine every week. The important topics covered in the weekly are analyzed and explained in a simple language, all from a [UPSC](#) perspective.

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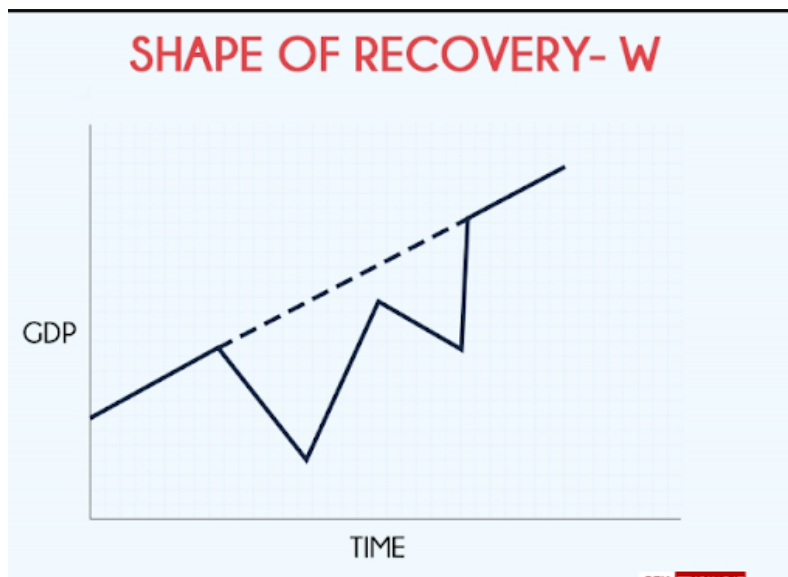
1. ‘W’-shaped Recovery

Context: Heading towards a ‘W’-shaped Recovery

What is W-shaped recovery?

- A W-shaped recovery is when an economy passes through a recession into recovery and then immediately turns down into another recession.
- The middle section of the W is significant, as **it represents a bear market or recovery from an additional economic crisis and the extent to which economic policies** are used to get the economy back on track.

Image : W shape recovery



Source: etmoney

What is GDP deflator:

- It denotes the ratio of the value of goods and services an economy produces in a particular year at current prices to that of prices that prevailed during the base year.
- This ratio helps show the extent to which the increase in gross domestic product has happened on account of higher prices rather than increase in output.
 - The deflator covers the entire range of goods and services produced in the economy as against the limited commodity baskets for the wholesale or consumer price indices —
 - It is seen as a more comprehensive measure of inflation.
- **Real vs nominal**
 - GDP price deflator measures the difference between real GDP and nominal GDP. Nominal GDP differs from real GDP as the former doesn't include inflation, while the latter does.
 - As a result, nominal GDP will most often be higher than real GDP in an expanding economy.

Recent trend reflected in the survey:

- The first advance estimates of the national income for 2022–23 released by the National Statistics Office show that the gross domestic product (GDP) growth has slowed down by 1.7 percentage points to 7%.

- But the 7% growth in 2022–23 itself is mainly on account of the **9.7% pickup in the first half of the year**. It means that growth is expected to slow down by more than half to 4.5% in the second half of the year.
- There are also concerns regarding the growth in the manufacturing sector, with growth reduced almost **two-thirds to 4.1% in 2022–23**.
 - The annual average growth of industry in the **last five years was just 3%, which is lower than that of agriculture**.
- **Manufacturing, accounting for more than half of the industrial output, but recently the growth is falling by almost nine-tenths to 1.6% in 2022–23**.
 - The annual average growth in this sector in the last five years was a mere 2.7%. So, any sustained recovery in the economy will require that this trend in industrial growth is substantially reversed.
 - Growth of output in mining and quarrying slid sharply by around **three-fourths to 2.4% in 2022–23**, that of construction slipped only marginally, and remained a high 9.1%.
- Agriculture sector prices have continued to pick up by around 2 percentage points to 9% in 2022–23, while that of the non-agriculture sector have declined by close to 2 percentage points to 9.3%.
- The **GDP deflator** is consistently hitting higher marks. It indicates the overall changes in price levels in the economy, slid only marginally by 2.4 percentage points to 8.4% in 2022–23.

2. Non-performing Loan Auctions

Background

- A Reserve Bank of India (RBI) bulletin on [Asset Reconstruction Companies \(ARCs\)](#) released in 2021 states that asset acquisition at an inflated cost through a “seller financing” approach is a recipe for disaster.
- Furthermore, the management fee structures that allowed ARCs to regain the de minimis upfront cash payment, even assuming zero recoveries from non-performing loans (NPLs), further accentuated the issue.
- However, the major concern in the entire process was the auction mechanism. Banks sold NPLs to ARCs using a contingent payment auction mechanism (CPAM) and the final proceeds to the bank were conditional upon the realization of the auctioned NPL.
 - CPAM has been used for awarding contracts for drilling oil reserves and for distributing spectrum.
 - It is important that features associated with CPAM are appropriately defined in order to prevent inflated bidding, moral hazard, and collusive behaviour.

Designing Security Bid

- The form of payment that can be used by the bidder should be defined first.
 - If the seller allows the bidder to decide the form of payment (i.e cash, debt, equity, etc) then it is called an informal auction.
 - If the form of payment is pre-defined then it is called a formal auction.
- The choice of security accepted in place of cash payment is the first question that should be evaluated by a seller using CPAM.
- In India, a combination of cash and debt as a security bid is adopted for NPL auctions. This makes the security flatter and reduces the seller's expected revenue.
 - It should be noted that the seller payoff increases if the security is steep.
 - Steepness implies the sensitivity of payment from security based on the outcome.
 - It should be remembered that the debt is the security with the lowest steepness while equity call options have the highest steepness (equity taking the median position).
- It is found in a study that if a bank is unable to distinguish between a low-type bidder (a bidder who will have a suboptimal outcome from loan resolution) and a high-type bidder, there is no assurance that it will receive greater proceeds by selecting a higher bid.
- Indian banks should choose the security with higher steepness.

Difference between formal and informal auctions

- It is found through the study that the equilibrium outcome in an informal auction is similar to a first-price auction where the bidder bids with the flattest securities. Therefore, bidders in an informal auction will prefer a cash bid.
- An informal auction will not result in higher revenues for banks.
- If the separation among the bidders does not exist, then the signals observed in the informal auction can help the seller in differentiating the types of bidders.
- The banks can infer the type of bidder from the first bid and use the fixed proportion bid to select the successful bidder and maintain revenue neutrality without a loss of separation.

Open and Sealed bid auction

- If the valuations of bidders are interdependent, open bidding increases revenue for the seller. This increase is due to the availability of additional information and a positive association in valuation assumptions among bidders.
- In open bidding, the private values of other bidders become public, thereby reducing the uncertainty of the bidder.
- The sealed bid auction offers the advantage of the reduced possibility of collusion and higher valuation if there is a large variation in private values.

- As considerable time and detailed loan features are provided during the NPL auction process, and the buyers are experts in underwriting NPL cash flows, open bidding is unlikely to reduce the fear of a winner's curse.
- Furthermore, a small number of eligible bidders (less than 30 licensed and active ARCs), the low capital base facilitates an environment to engage in collusive behaviour.
- Thus, sealed bidding is better as compared to open bidding.

Payment Priority

- Currently, the expenses incurred by ARCs and management fees have the first priority on any cash flow generated from NPL resolution. The remaining cash is distributed between banks and ARCs in the proportion to their investment.
- If the recovery of the amount invested by ARCs was subordinated to that of the bank, then ARCs would have been motivated to find the best resolution method. This would maximize the NPL recovery.
- The use of a contingent payment auction mechanism promotes competition in a scenario where bidders are capital constrained.
- It should be noted that the ARCs in India are thinly capitalized because of historical restrictions on [foreign direct investment](#). The combined equity capital of all ARCs is below 40 billion (less than 2% of the overall outstanding NPL).

Conclusion

- It is recommended to review the choice of security used by banks in CPAM and the policy to make the cash component a predefined portion of the aggregate bid.
- Additionally, banks should use a senior-subordinate payment structure and insist on a higher upfront cash payment.
- A periodic review of ARC's performance should be coupled with penal actions in case of negligence.

3. New Global Order

Context: The rise of a Multipolar Global Political Economy.

What is meant by a multipolar world?

- After the [second world war](#), the world was divided into two power centres i.e **America and Russia**. They contributed to the rise of a bipolar world in which two countries had dominant power structures across the world.
- After the disintegration of the USSR in 1991, the world is said to have gone into a unipolar world situation where America had the dominant power.

- But, the present world has given rise to the concept of a multipolar world where the power centres are being shared by many countries. In other words, there are no one or two powerful countries, instead, there are many power centres.
- **A multipolar system is a system in which power is distributed at least among 3 significant poles concentrating wealth and/or military capabilities and able to block or disrupt major political arrangements threatening their major interests.**

Signs of the changes:

- The United States (US) seeks to maintain a unipolar world order where its hegemony is unchallenged.
- Russia and China have been trying to enforce multipolarity for three decades. Much of the global South has opted for strategic autonomy and neutrality in this period of heightened rivalry and war.
- Commercial centres, which are believed to be the powerhouse of economic activities, earlier concentrated in the West, have diversified to the “emerging economies” of the developing countries in the global South.
- Many emerging countries are reducing their dependence on the American dollar and trying to carry out trade in their domestic currencies.
 - The BRICS’s [New Development Bank \(NDB\)](#) disburses in national currencies since 2015. By 2019, \$15 billion was disbursed in national currencies. This proved to be more economically advantageous for the growing economies.
 - Asian central banks have more than **\$400 billion of local currency swap** lines and trade among themselves in national currencies.
- India too has been pushing for trade in local currency. To facilitate trade in Indian rupees, the RBI has allowed the creation of “Special Vostro Accounts” in designated Indian banks for trade with Russia.
- This move will make the Indian rupee an international currency. It will enable India to save up to \$4 billion a month that goes out of the country, which will be a substantial relief in the trade deficit of \$20 billion–\$25 billion right now.

Reasons for diversification of the global economy:

- There has been fast growth in emerging economies. The combined gross domestic product (GDP) in purchasing power parity (PPP) of China, India, Russia, South Africa, Indonesia, Brazil, Iran, and Turkey is now larger than that of the combined [G7](#).
 - **The World Bank showed that China contributed to 30% of the global economic growth since 2009.**
 - **The digital revolution is propelling China, India and many Association of Southeast Asian Nations ([ASEAN](#)) countries forward.**
 - **Russia has continued to survive despite the global ban on its economy.**

- Alternative institutions to the IMF and the World Bank are emerging. **For example, the New Development Bank, AIIB, etc.**

With the change in the economic status of countries across the world, there has been a proportionate shift in geopolitics. The world is moving closer to a multipolar world, which will lead to more diversification of the economy and thereby change conventional power structures. Multilateralism is more suited to the needs of developing countries, which would offer them more opportunities for growth and development.

4. New tech market

Context: Rise in the wave of digitisation has brought forth many intertwined issues with respect to competition fairness.

Detail:

- Technological change has brought about huge changes in the economy and society of many countries. Rapid economic progress and employment generation became possible only due to the advent of technology.
 - **India has improved its position in the [Global Innovation Index](#), moving from 48th place in 2020 to 46th place in 2021. According to Gartner, IT services will expand by 10.7%, up to \$18.103 billion in 2021, up from 3% in 2020.**
- Technological innovation has enabled us to bring drastic changes in the field of **governance, health facilities, and education and to raise the level of accountability.**
- Moreover, **penetration of technology in all likelihood would increase** in the future and thus raises concern over the issue of **competition, privacy and many other important issues.**

Issue of competition in the technological market:

- The digital market passes through a cyclical period. The dominant position obtained by a business can be easily replaced by other emerging businesses. **As a result, big businesses try to create hurdles for budding enterprises in the markets.**
- In the digital market space, **large-scale data collecting and analysis has become encompassing**, potentially influencing anti-competitive results.
- Network effects give undue advantage to the larger companies thus causing the “bigger takes it all” effect.
 - **Network issue refers to a phenomenon whereby a product or service gains additional value as more people use it.**
- Further, using their deep pockets the larger companies can provide more subsidies and discounts to their customers in order to remove the potential competition from the market.

- Several online companies have used significant discounts, cash-back offers, and other programmes to lure prospective users and establish the network effect.
- Additionally, digital businesses compete by developing new business strategies and constantly establishing new markets through a range of new products and services.
- Mergers and acquisitions lead to the **outflow of data from one company to another without the prior approval of the consumers.**
 - According to IBM, 90% of the world's data has been created at 2.5 quintillion bytes each day in the last two years.

Remedial measures needed:

- In the digital space, mergers and acquisitions need antitrust authorities to review agreements based on an in-depth analysis of the marketplace.
- Disruptive inventions that disrupt established marketplaces must be thoroughly assessed, emphasising their pro-competitive implications and consumer advantages.
- If the primary purpose of an acquisition or merger is to acquire new data, which would increase **post-merger data concentration**, market domination and the creation of entry barriers for new entities and start-ups, then such merger should be discouraged.
- The regulator should assess the merger in terms of **customer choice, innovation, and improving the quality of products and services.**
- The aspects that impact customers' decisions in marketplaces, such as price, quality, and innovation, should be subject to competition law. Under those circumstances, the authorities must take additional measures to deal with such issues.
- Competition law authorities must **revise abuse of dominance**, and **look into the intention of the merger** that is taking place in the digital space.

India is one of the fastest-growing economies in the world and many new startups are making new entries. Under these conditions, it is cardinal that the market supplements the efforts of the enterprises by creating a level playing field for them.

5. Supranational Renewable Energy Alliances and South-Asian Countries

Context: An article highlighting the importance of taking comparative advantage of different companies with reference to energy generation.

What is a supranational entity?

- A supranational energy union would mean that companies in the two giant countries of India and China could internationalise and use their advantages in technological superiority and manufacturing prowess to create an economic advantage.

- The main idea here is to **leverage the advantage** that these companies have while operating in any country.

What is the need for such an entity?

- The nature of the problems faced by the countries in Southeast Asia is the same. At the same time, these countries are developing statuses which require coordination from one another.
- It will enable the companies operating in different countries to leverage the comparative advantage in terms of cost of input, and technological superiority.
- Climate change has become a central issue in the present context. So, taking the advantage of relative benefits, total **carbon footprints cast on the environment can be reduced to the maximum level.**
- India and its neighbours are suffering from energy crises of varying natures and degrees. Some of the neighbours are poor at establishing energy generation capacity owing to technological limitations or lack of expertise.
 - Nepal has inked a USD 1.3 billion deal with Satluj Jal Vidyut Nigam (SJVN) of India to develop a 679-megawatt hydropower project.
- India and China have reached a higher level of technological sophistication, which has allowed them to create industries in the renewables sector, specifically in the solar and electric automotive industries in order to help their neighbour.

Advantages of these entities:

- Poverty reduction and access to energy are the targets to be achieved under [SDGs](#) by the end of 2030. The establishment of such an entity would help in making energy accessible to every section of society.
- It will enable corporations to meet the dual task of earning profits and meeting the social obligation of **responsible capitalism.**
- The establishment of **Supranational Renewable Energy Alliances** would help in **reducing the cost of generating electricity** and thus enable it to take comparative advantage.

Collaboration in the field of energy creation would help in overcoming the limitation imposed by funding and the climate crisis.