# Opinion

THURSDAY, JANUARY 24, 2019

**CHANGING OF THE GUARD**

Angela Merkel, German Chancellor

"Countries like China and India are affecting the global economy much more today and the global organisations need to take that into account"

## Forget selling PSUs, govt can't even shut loss-makers

### While 157 made losses of ₹30,678 crore in FY17, govt planned to wind up 19 but only two have been shut so far

**THE GOVERNMENT'S INABILITY** to free up PSUs has already resulted in a valuation loss of ₹12.8 lakh crore (*goo.gl/VcbFQB*) since the Narendra Modi government assumed office, but for reasons best known to it, the government hasn't been too keen to push an aggressive privatisation strategy. Even the Air India privatisation was half-hearted since the government refused to take over all the debt and put in several other riders that potential buyers found onerous. Apart from the fear of a backlash from workers, one possible reason was that the government felt it could turn around the PSUs by giving them greater autonomy in the same way Modi did with state PSUs when he was the Gujarat chief minister. But since no move was made to get Parliament to change the law that treats PSUs as "instrumentality of state", the restrictions remain and PSUs have lost value because of that; even banks where the government set up an elaborate structure to insulate them have lost around ₹3.7 lakh crore in value.

Despite the reluctance to privatise PSUs, the government's plan to shut perennially loss-making PSUs appeared a good one since this would also mean a large saving—in FY18, 71 loss-making PSUs posted a loss of ₹31,261 crore, up 14% over that in the previous year. Except, as *FE* reported last week, just two of the 19 units identified have been wound up so far in the last five years; these two are relatively small units while the big loss-makers like Hindustan Photo Films, HMT, IDPL and Tungabhadra Steel Products are still awaiting closure due to a variety of court cases. Hindustan Photo Films has not produced anything for several years but continues to make losses—it has 217 employees and made losses of ₹2,917 crore in FY18. Amazingly, the government has not taken a decision to close down even MTNL that lost ₹2,941 crore in FY17 despite the fact that it has a market share of under one percent and its closure will make no difference to the market—indeed, with its spectrum lease ending next year, even assuming no change in spectrum costs will mean the government will have to infuse another ₹4,000 crore or so to renew the spectrum licence.

What is worrying is the fact that, over time, PSU losses will keep increasing. While the ₹158,373 crore of FY17 profits of 212 PSUs look healthy, over three-fourths of this comes from sectors like oil, coal and power where PSUs have a near monopoly or get favoured treatment. Interestingly, India's highest imports take place in sectors where PSUs dominate like coal and oil; their poor performance means imports are required to meet the country's demand. According to the latest CAG report on PSUs, 11 of 34 listed PSUs have an interest cover of less than one—that is, these PSUs are not earning enough to even repay their expenses on interest—and, in the case of unlisted firms, 66 out of 124 PSUs are in this situation; 71 PSUs have completely eroded their net worth and, by March 2017, had a negative net worth of ₹71,935 crore. If a government with a majority of the sort Modi has got has been unable to either privatise or shut down PSUs, it is not clear whether the next government will be able to make much headway; more so if, as the ongoing HAL-Rafale controversy shows, keeping PSUs alive has become the benchmark by which to judge a government's intent.

## Creating more NPCIs

### It has done a great job so far, but more competition good

**WHILE THE NATIONAL** Payments Corporation of India (NPCI) has done a good job of handling retail payments and also encouraging innovation, it is time to diversify risks and usher in some competition. RBI's paper on whether new retail payment systems should be initiated could not have been more timely. There can be no argument whatsoever against spreading risks. RBI must be apprehensive of creating a 'too big to fail' institution which is what NPCI could become given the pace at which retail electronic payments are growing and will continue to grow. There is, therefore, a sound reason to encourage the creation of more pan-India platforms. In October 2018, NPCI accounted for nearly 50% of the volumes of retail electronic payment transactions (excluding paper) and 15% of the value. There is enough of a case to have another two NPCIs since electronic payments are going to grow exponentially. Already, non-bank entities now co-habit the payments space either as technology service providers or by themselves providing retail electronic payment services. There is no reason why we can't have more payments platforms with even non-banks promoting them.

Indeed, with the bigger banks calling the shots at NPCI—which now operates IMPS and UPI, including BHIM, National Financial Switch, Aadhaar enabled payments system (AePS), BHIM Aadhaar Pay, RuPay and other payment systems—the smaller banks feel their interests are being sidelined. In particular, the big banks have been opposed to increasing the inter-change rates for AePS, ostensibly for fear of losing market share in smaller towns. Consequently, they have been dragging their feet on the proposal for about a year now. Indeed, smaller banks are also upset that they do not have an option when it comes to CTS—cheque truncation—since it is operated by NPCI. RBI is right in suggesting there should be competition because, in its absence, innovation could be stifled. While UPI is a good innovation, there could always be technological advancements that might not be utilised on a broad enough scale if the larger banks don't want them.

The Watal committee, while stressing the importance of competition, had pointed out that competition in itself may not foster innovation since very high levels of competition, could, at times, reduce the incentive to innovate as it could lower the profits of a firm trying to catch up with rivals. Nonetheless, the committee believed competition was critical to the growth of the payments market. It also noted the law currently does not impose any obligation on the regulator to promote competition and innovation in the payments market and that these should be amongst the primary objectives of the regulator.

## MuddledThinking

### The govt has created yet another absurd distinction in its pursuit of political expediency in retail FDI policy

**THE LATEST CHANGES** to India's FDI policy for retail reflect continued muddled thinking on the part of the government. After creating the single-brand/multi-brand distinction in allowing FDI in retail in a bid to allay the fears of Indian organised and *kirana* retail, the government has now eased the local sourcing norms for FDI in single-brand retail. Only, it has created another absurd classification in the process—large and small single-brand players. The government is mulling over a proposal to allow large foreign investors—they should be bringing in $200-250 million in the first two-three years—more time to comply with the 30% local sourcing condition it has set for 100% FDI via automatic route in single-brand retail. Currently, all 100% FDI in single-brand retail must comply with the local-sourcing rule upon completion of the first five years of setting up shop in India. While this makes it easier for an Apple or an Ikea to establish a fully FDI-funded presence in the country, it skews the playing field for smaller players.

Successive regimes at the Centre, playing to a gallery of Indian organised and *kirana* retail, have mastered the art of creating complicated regulatory structures for foreign investment in organised retail. But, the unfortunate bit is that the government keeps tripping up on hurdles of its own creation. For instance, even though the FDI policy for multi-brand retail remains heavily restrictive—the unstated logic is that a liberal policy will negatively impact Indian organised and *kirana* retail—the government let such investment come in in e-commerce, which, arguably, has had a larger impact on Indian organised and *kirana* retail. Indeed, the 'investment in B2B e-commerce ok, not B2C' fig-leaf allowed e-commerce players in India to plead that they were merely marketplaces facilitating vendor/retailer-buyer linkage. The government has recently imposed serious restrictions on e-tail, but that is further evidence of the government's belief in deliberate confusion as (politically) sound strategy for retail FDI.

**LOSING ALTITUDE**

MERGING AIR INDIA WITH JET WOULD PUT AN END TO DESTRUCTIVE DISCOUNTING IN THE AVIATION MARKET

# Bloated Maharajah needs to get hitched

DAVID FICKLING

Bloomberg

**TO HAVE ONE** airline limping forward on the brink of bankruptcy may be regarded as a misfortune. To have two looks like carelessness. That is the fundamental problem for India's aviation industry, home to the critically ill Jet Airways India Ltd. and its state-owned rival Air India Ltd., which more or less died in 2012 but has been kept on life support thanks to ongoing infusions of taxpayer cash.

Facing collapse, Jet has been trying to restructure its debt and seeking bailout money from founder Naresh Goyal and leading shareholder Etihad Airways PJSC. Should those attempts fail, PM Narendra Modi will have to explain the loss of 23,000 jobs ahead of the May elections.

Air India, known locally as the Maharajah, has been in similarly dire straits. An attempted privatisation last year attracted zero expressions of interest. The government is considering a fresh turnaround plan, *The Indian Express* reported in September.

The problems are interlinked. Due in large part to excessive fleet acquisitions during the 2000s, the Maharajah has been crushed under the weight of his spending. Net debt was about ₹454 billion ($6.4 billion) in March 2017, the last time Air India published a balance sheet. Debt has since risen to about ₹519 billion, according to *The Times of India*.

If it wants revenue to pay that mounting bill, Air India must somehow maintain its market share, in spite of notoriously bad service and on-time performance, and competition from budget upstarts SpiceJet Ltd. and InterGlobe Aviation Ltd., or IndiGo. The tactic it has used to thread that needle has made matters worse: discounting.

Have a look at the passenger yields for the big four carriers reported to India's Directorate General of Civil Aviation and you will see the problem. While Jet has kept yield—a measure of passenger revenue, per seat, per kilometre—at a decent premium to IndiGo and SpiceJet, Air India has been busy matching or even undercutting the no-frills competitors.

That is not really helped anybody. With its bloated balance sheet, the Maharajah would probably be losing money regardless of what it does (finance costs and depreciation alone typically chew up about 30% of revenue, compared with 5% or so at Jet). But Jet has long been tantalisingly close to covering its costs. Were it not for the necessity of competing for full-service passengers with a rival that doesn't seriously expect to break even, it might even be able to make a profit.

Of course, life would still be tough, given fearsome competition from IndiGo, as my colleague Andy Mukherjee wrote earlier this month. Still, full-service carriers do manage to survive and even thrive in markets transformed by the budget aviation revolution, as the experience of incumbents competing against Southwest Airlines Co., Ryanair Holdings Plc and AirAsia Group Bhd. has demonstrated. What is unique about India is that the top end of the market is in the grip of the same deflationary mania as the bottom bucket.

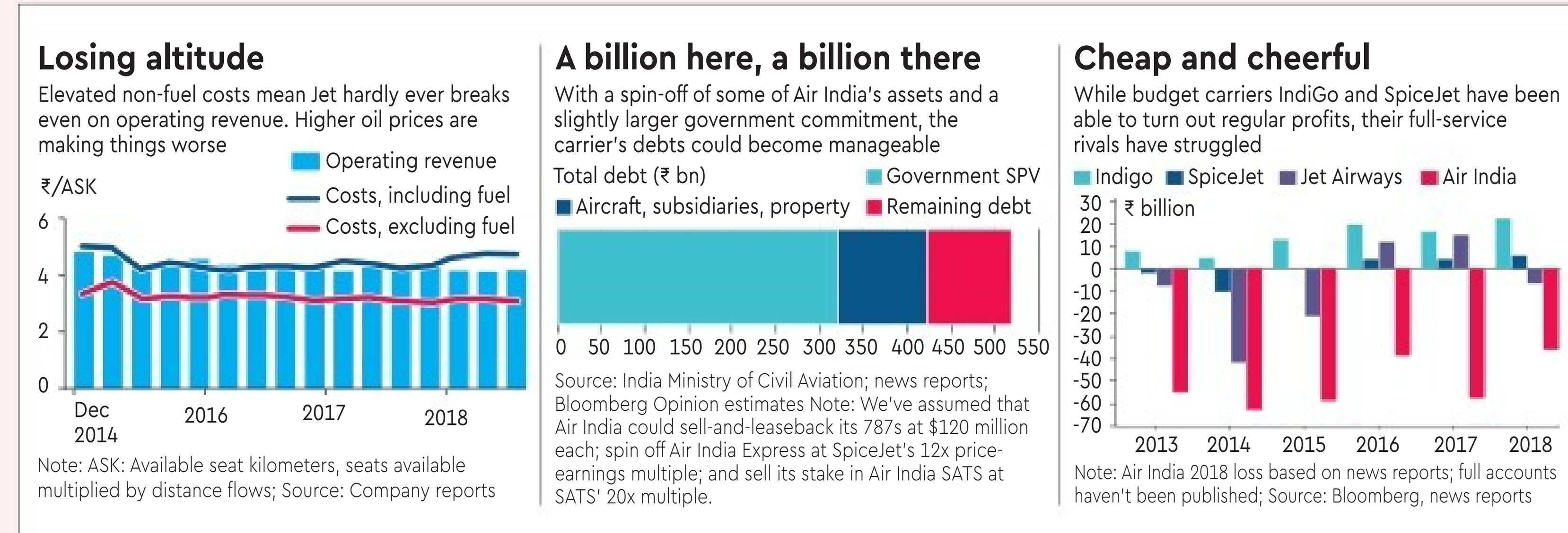
The answer is to kill two birds with one stone. Jet quickly ruled out a bid for Air India when its privatisation was put out to tender last year, but a sweetened deal that wiped out more of the state-owned carrier's debt might be enough to put the combined group on a stable footing.

Combined ebitda at the two companies averaged about ₹55 billion in their 2016 and 2017 financial years. If New Delhi absorbed another ₹80 billion of debt on top of the roughly ₹250 billion it committed to under last year's privatisation plan; sold and leased back Air India's six remaining fully owned Boeing Co. 787s; and spun off its budget carrier, ground handling business, and property portfolio; then the aggregate debt bill for the two companies could fall to a high-but-manageable ₹200 billion or so.

That 3.6 times net debt-to-ebitda ratio would drop to still more comfortable levels if the combined group was able to lift ticket prices, something that would be easier in the absence of Air India's suicidal discounting. Luckily, the seasoned professional management that the Maharajah so desperately needs would be on hand in the shape of Goyal, Jet's chairman, and his executive team.

Such an airline would still need to work hard to escape its legacy of losses—but it would at least have a chance to become a robust global aviation player. That should be considered the birthright of a country that already has the world's largest diaspora and fastest-growing aviation market, and will soon have the largest middle class.

Given the politically hazardous need for state banks to absorb losses, it is unlikely that any such resolution will come before the elections. But Modi, or his successor, shouldn't regard kicking the can down the road on Air India's debts as the low-risk option. The Maharajah's 2012 government bailout was one of the final straws contributing to the collapse of Kingfisher Airlines Ltd., which had once aspired to be a third full-service player. New Delhi should take care that history doesn't repeat itself.




Note: ASK: Available seat kilometers, seats available multiplied by distance flows; Source: Company reports

Source: India Ministry of Civil Aviation; news reports; Bloomberg Opinion estimates Note: We've assumed that Air India could sell-and-leaseback its 787s at $120 million each; spin off Air India Express at SpiceJet's 12x price-earnings multiple; and sell its stake in Air India SATS at SATS' 20x multiple.

Note: Air India 2018 loss based on news reports; full accounts haven't been published; Source: Bloomberg, news reports

# E-com FDI changes spur more uncertainty

### The CCI has noted that it is the right of a manufacturer to choose the most efficient distribution channel and said this choice ought not to be interfered with, unless the said choice leads to anti-competitive effects

ABIR ROY

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**THE RECENT FDI** norms with respect to e-commerce have created quite a stir in the market with varied opinions being put forth. It has been reported that the new norms have come as a surprise to dominant e-commerce companies since they now need to tweak their operations substantially. The revised FDI norms come in the backdrop of objections raised by retailers and traders against these behemoth e-commerce entities on practices of predatory pricing and loss funding; and the web of preferential sellers created by such dominant e-commerce players.

Having said that, there were certain regulatory norms which existed even in the previous avatar of the FDI regulations. The most prominent being (a) after sale services were the responsibility of the seller and the name of the seller was to be conspicuously mentioned in the e-commerce portal to ensure that after sales services were the responsibility of the seller and (ii) these e-commerce players should not have any control or influence over the prices of goods sold on the platform. The reason for having this norm is that these online portals remain a pure play market place.

While these regulatory restrictions were present previously, recently, the CCI, in its order in relation to Snapdeal, has made certain key observations which throw specific aspects of the operations of e-commerce players into the limelight. The CCI has noted that (i) when the sales are made possible through the online platform, and in case of any issue/requirement/discrepancy, the end consumer/customer can approach the online platform for redressal, i.e. for after sales services and more importantly (ii) while various dealers/distributors of manufacturers offer a particular price to the online portals, it is the prerogative of such online portals to decide the incentive/discount it wishes to offer to its customer on the relevant product. The CCI further notes that, even if the online portal decides to list a particular product at a price lower than the agreed price or provides cashback to the buyer(s), the dealer/manufacturer cannot legally interfere in such matters.

Thus, the CCI noted that, to say that the online portals have no role or influence over the prices, may not be correct. It must be noted that these observations were made by the CCI after a thorough investigation. While these observations were in relation to Snapdeal, it would be safe to presume that these practices are also followed by other dominant e-commerce players, which, in turn, begs the question, of whether they were following the earlier FDI restrictions *in toto*. These aspects further emboldened the fact that there is an urgent need of a quasi-judicial body to ensure compliance of all FDI norms in letter and spirit.

> **The allowance of discounting strategies of the online portal can adversely affect the dealership network of the said manufacturer**

Another interesting aspect of this case is that the CCI has given a shot into the arm of manufacturers to ensure their dealership network is not at risk due to low prices offered on online portals. There was a concern that was raised by all manufacturers that they want to ensure there are no practices which affect their dealership network, however, they were hamstrung as they could not force the online portals to sell the goods at a particular price due to a widely debated competition law, both in India and worldwide, due to a prohibition of resale price maintenance ("RPM").

The CCI, in this case, has deliberated in detail the concept of RPM in India and noted that, unlike in some other jurisdictions, RPM is not a hardcore restriction but has to be assessed by the rule of reason test and needs to be seen on the basis of facts of each case like market power, etc, and whether the said practice causes an appreciable adverse effect on competition in India. Interestingly, the CCI has noted that it is the right of a manufacturer to choose the most efficient distribution channel and said this choice ought not to be interfered with, unless the said choice leads to anti-competitive effects. Also, the CCI has noted the manufacturers' defence that they have made considerable investment on creating its dealership network.

Dealers set up the showroom, spend money on display and pre-sale services and, thus, such dealers expect to be incentivised for making such investments. The allowance of discounting strategies of the online portal has the potential of adversely affecting the dealership network of the said manufacturer. All in all, the wide ranging debate of e-commerce continues and it would be very interesting to watch out for this space.

## LETTERS TO THE EDITOR

### Scripting another record

Indian skipper and run-machine Virat Kohli deserves accolades for scripting an unprecedented clean sweep of the ICC annual awards, announced on Tuesday. The champion batsmen bagged the Sir Garfield Sobers Trophy for ICC Cricketer of the Year, ICC Test Player of the Year and ICC ODI Player of the Year. The Indian skipper was also named the captain of ICC's Test and ODI Team of the Year. This is the second year on the trot that Kohli has won the Sir Garfield Sobers Trophy for the ICC Test Cricketer of the year which is a stupendous feat. Carry on Kohli, you have earned your stripes!

— Ravi Chander, Bengaluru

### Reviving Gandhi glitz

The appointment of Priyanka Gandhi as General Secretary in charge of the eastern part of the pivotal state of Uttar Pradesh marks her formal entry into active politics and comes as an exciting new development. It is certain that she will revive and inject some of the old Gandhi glitz and glamour into the party's rank and file and the masses. No one is now left in any doubt that she will bolster the Congress morale and invigorate the upcoming general election. BJP's reaction to her political plunge that it attests to dynastic politics and that Rahul Gandhi has failed is flimsy, but hardly surprising. Priyanka Gandhi closely resembles Indira Gandhi, but time alone will tell whether she proves to be as charismatic as her grandmother. Nevertheless, the up-and-coming Priyanka Gandhi must articulate what she represents (it is just not enough to leave the people to be satisfied with the thinking that she perhaps shares her party's ideology) to gain wider support and acceptance

— G David Milton, Maruthancode

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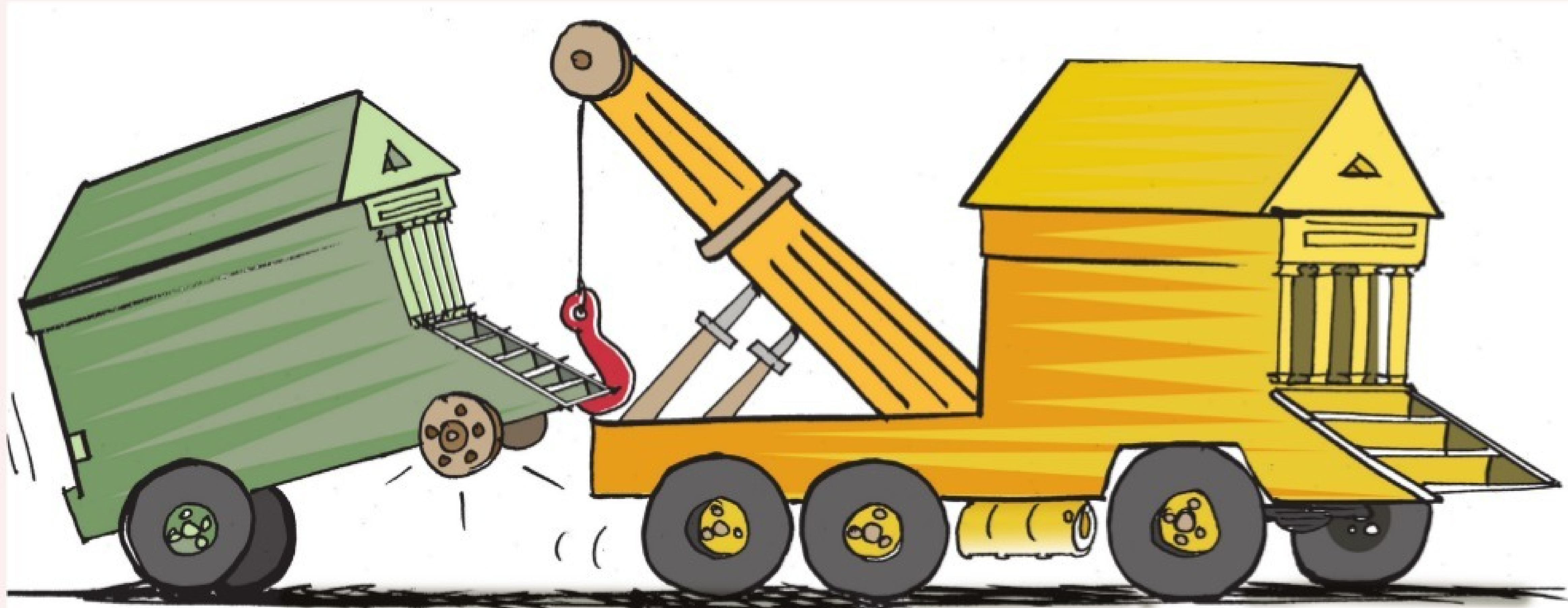

ILLUSTRATION: ROHNIT PHORE

# Back to a nationalisation mindset?

BANKING SECTOR

The govt's push for SME loans via PSBs, relaxing the IBC norms for NPAs in certain sectors and relaxing the capital conservation requirement for certain banks smacks of the prevalence of the policy mindset that brought about bank nationalisation

MADAN SABNAVIS

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Views are personal

**NATIONALISATION AND FINANCIAL** sector reforms have been two major milestones in Indian banking, making 1969 and 1992 landmark years in India's history. While financial sector reforms brought about a sea-change in the way in which India does banking, there is a sense now that we may just be going back to the 'command economy' days.

Nationalisation was about driving the socialist dictat where mass-banking was the guiding principle, and banks were to be used as instruments for delivering social good. Banks were taken over by the government, and only the small, niche players remained, the ones that are called the old private banks today. The rest became public sector banks. Once owned by the government, they were used for furthering political agenda and initiatives like loan melas caught on where favours were forcibly dispensed. There was scant attention paid to loans being serviced or repaid, and, therefore, banks looked very profitable as their asset size increased. Appointments were made by the government and, in return, compliance was the norm. More importantly, there was little accountability and rarely were the banks questioned. Default in debt service by borrowers was addressed by giving additional loans so that the earlier ones could be repaid. The system was in a comfortable equilibrium.

Once we entered the world of reforms, the Narasimham Committee was instituted where the best global norms were studied and implemented very well. This brought in income recognition standards and the quality of assets was important. Once an asset turned non-performing, provisions had to be made, which brought down the profits. Also, lending was benchmarked against the 'own capital' of the bank, and, hence, capital adequacy standards came in. It took around a decade for the system to adjust fully. Competition was ushered in through new private banks that provoked comparisons regularly.

Both sets of banks have progressed well on a comparable scale, and technology, which has been a driver for the private banks, has been adopted by the PSBs, too. The quality of service in PSBs is comparable today to that in private banks, and the product offering is on a par though there could be some laggards in the PSB ecosystem where legacy issues have to be fully tackled. The case of overstaffing in PSBs is also a thing of the past, and the difference in culture has come down.

However, PSBs still have some major challenges that are remnants of the nationalisation days. First, they continue to be owned by the government, which means appointments are driven by a different ethic. Second, they continue to be the tool to drive the agenda of the government; a very good example is the Jan Dhan scheme that had been pushed on these banks irrespective of the viability. Third, the focus on SME loans, through the MUDRA window, is also a PSB task. Fourth, when infrastructure had to be funded after the DFIs got converted to banks; the onus fell on these banks that had to perforce channel funds to sectors like power, telecom, steel, textiles, etc. A large part of these loans have turned NPAs, an issue that is at the core of the larger problems facing the banking sector today. Fifth, when farm loan waivers are announced by the government, they cover the loans disbursed by PSBs, and anecdotal experience shows that often banks find it hard to get the money from the government when the latter has fiscal strains; this, in turn, leads to write-offs at a later point of time. Sixth, while interest rates are supposed to be freely determined by banks based on commercial considerations, often PSB heads are summoned to North Block and given instructions to lower interest rates. Seventh, political calls on loans have been a part of tradition where bankers may have to disburse loans on 'instructions from above', though this has reduced considerably of late. Eighth, targets are actually set on farm loans in the Budget, and passed on to the PSBs that have to ensure that the growth rate is maintained—this could be beyond the 18% priority sector stipulation already there.

It is not surprising that contradictions have surfaced in the form of PSBs saddled with several challenges. The important question is that a call has to be taken on whether or not we are serious about banking reforms and maintaining the sanctity of the system. The problem is not with the concept of a PSB, but with the processes involved and the lack of independence in operations. This kind of ambivalence has made the situation puzzling.

Hence, while we have taken several good points from the Narasimham Committee Report and implemented them to make the system world-class, at the operational level, there has been a flip-flop attitude. The approach towards prudent regulation has also been hazy. While moving to the 90-day norm was well implemented when the infra-NPA pile came up, soon enough, it was back to the days of nationalisation where we followed the policy of evergreening assets to book lower NPA levels. This escalated the problem to such proportions today that it has become hard to overcome.

The same mindset is in play when it comes to SME loans. While there is a genuine concern here, the can has been kicked once more by allowing for restructuring. It was done post-demonetisation and once again this year. It may be hoped that this is a one-off case and is not replicated in the years to come.

We have actually done very well on capital adequacy norms by pursuing an aggressive policy. While relaxing the norm on capital conservation buffer (0.625% to March 2020) to release capital for lending will not impinge on the strength of the system, it is the compromising mindset that is a concern as it sets precedents that can be used for further relaxation of norms in future. Also, the call on relaxing the standards for NPA recognition in certain sectors in the context of the IBC has meant moving a few steps back.

The time has come for us to take a concerted view on the banking system. While going strictly by the book can have pitfalls in terms of bringing in considerable rigidity, flexibility should be the last resort and not the first option. Otherwise, as can be seen, the general mindset has tended to move back towards the days of nationalisation where the 'social cause' became a justification for all actions. While there is nothing wrong in both the models, moving continuously from one to the other not only smells of uncertainty but also fails to anchor the main objectives of the system. If we opt for the old school, then there should be less discussion on prudential regulation and more on over-riding social benefit. We cannot have both for certain.

# GST: Many miles to go

MEKHLA ANAND & ABHILASHA SINGH

Anand is partner and Singh is senior associate, Cyril Amarchand Mangaldas

A good and simple GST seems to be caught in many traps, from the federal structure of the tax to issues on simplification of filing returns

**THE GOODS AND** Services Tax (GST) legislation was introduced with a big bang in July 2017. Any criticism regarding the lack of readiness of systems/assessees and the anxiety of transition was countered with analogies referencing various facets of an Indian wedding. It was decreed that order would ultimately prevail over the chaos, and India would witness a magnificent celebration of another generation of financial reforms.

Needless to state, the initial transition has been fraught with conflict on issues ranging from failure of the GST portal to handle the transactions, management of multiple state-level registrations and their consequential compliance requirements, invoice matching etc. Indeed, 2018 stood out as the year where, with the ceremonial fervour finally out of the way, issues in the finer print began to emerge.

Loss of input tax credit due to the manner in which transitional provisions are structured, whether basis the nature of items involved, the arbitrary limitation period specified, ineligible credit for erstwhile cesses, lack of foresight for those availing location based incentives prior to GST, has set the stage for the next round of litigation. Similarly, while recourse to the Authority of Advance Ruling has been the flavour of the season, the government clearly discounted the possibility of divergent views by different state authorities, something that has been evident in recent GST Council deliberations.

The anti-profiteering provisions are yet another example of antipathy, given the lack of clarity on the methodology for computing the benefit to be passed on to the recipients. Basic harmonisation of legislations which link into GST such as the Foreign Trade Policy or the Customs Act are also a long way from the desired end.

For a system which was required to simplify, stabilise and bring down the level of discord, the GST experience has been quite capricious.

> States are developing alternate mechanism to increase their tax base by levy of local body entertainment tax or similar local body taxes. Also, state-specific incentives have been announced via state industrial policies, which are bound to create disparity in the national market

GST was visualised as a regime of reduced compliances and minimal physical interaction with the authorities; the e-way bill continues to result in unnecessary stalling/seizure of goods and harassment at the hands of the authorities due to minor technicalities and breaches. While the banking sector was still grappling with its transactional reporting requirements, the e- commerce sector now faces the challenge of the Tax Collected at Source (TCS) provisions.

The GST regime regrettably is also falling prey to the federal mechanism of our Constitution as states are developing alternate mechanism to increase their tax base by levy of local body entertainment tax or similar local body taxes. On the other hand, state-specific incentives have been announced through state industrial policies, which are bound to create disparity in the national market.

Perhaps what is most concerning in the present is that there is still no roadmap for a GST 2.0 which would resolve fundamental concerns such as the simplification of returns, e-wallet payment options, inclusion of petroleum products within the ambit of GST, rationalisation of refund processes for exporters and unutilised input tax credit to due inverted duty structure. Till these issues are resolved, 'happily ever after' remains a distant goal.

*With inputs from **Rupa Roy**, associate, Cyril Amarchand Mangaldas*

# India must act soon on plastics

Asia contributes 82% of plastic waste leaking into oceans with China, India and ASEAN contributing 2.7-7.3 mt pa

SAMEER CHOPRA

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**ASIA CONSUMES 50%** of global plastic packaging, which could quadruple by 2050. Food, beverage and healthcare represent 75% of plastic packaging use. New consumption patterns, including Asia's rising appetite for e-commerce and food delivery (+84% y-o-y) add to demand for plastic packaging.

Recycling rates are low, with the exception of Japan (83%) and Taiwan (35%). Hence, unfortunately, the region contributes 82% of plastic waste which leaks into oceans with China, India and ASEAN contributing 2.7-7.3million tonnes pa. Recent media attention and political impetus (G10 initiative) will see plastic waste become a key focal point for government intervention.

Australia, Japan and Taiwan have targeted regulatory effort at manufacturers. China and Indonesia introduced surcharge for plastic bags. Mumbai recently set ₹5,000 fine for plastic bags and bottles. Korea looking to exit coloured plastic bottles by 2020 and Taiwan all plastic packaging by 2030.

Tackling plastic packaging will see retooling of the supply chain, with associated cost and capex. We examined disclosure from 41 companies in Asia exposed to plastic packaging—packagers/petrochem (12), FMCG/Retail (22) and pharma/electronics (7). We see higher risk for "coloured flexibles", e.g., and snack packets, over "rigids", e.g., shampoos and beverage bottles.

Plastic represents 37% of packaging in Asia, worth $150 billion. Plastic consumes 6% of global oil and at current growth rates could account for 20% of oil consumption by 2050. Now, there are obvious benefits of using plastic: durability, safety, hygiene, and lightweight. However, 95% is designed for short-term (single) use and could take more than 500 years to biodegrade.

Since the early 1950s, more than 8.3 billion tonnes of plastic has been produced globally but only 9% of plastic waste ever produced has been recycled, 12% incinerated and 79% ended up in landfills, dumps or the natural environment.

Plastic waste dumping in the ocean is becoming an increasing environmental concern. By 2050, the amount of plastics in the ocean will equal to the total weight of fish in the ocean. The major rivers in Asia carry more than 90% of plastic waste in the ocean. The Asia-Pacific Economic Cooperation (APEC) estimates that the cost to tourism, fishing and shipping industries was $1.3billion in the region alone.

Majority of the plastic waste in Asia is "mismanaged". Low economic value contributes to the circa 45% of Asia's plastic waste which is mismanaged (i.e., dumped). Recycling rates are disclosed by some markets—Australia (14%), Japan (82%), Singapore (7%) and Taiwan (35%).

## Few markets measure recycling rates

Reporting of plastic generation and recycling varies across the region. Countries that disclose clear metrics include Australia, Japan, Singapore and Taiwan.

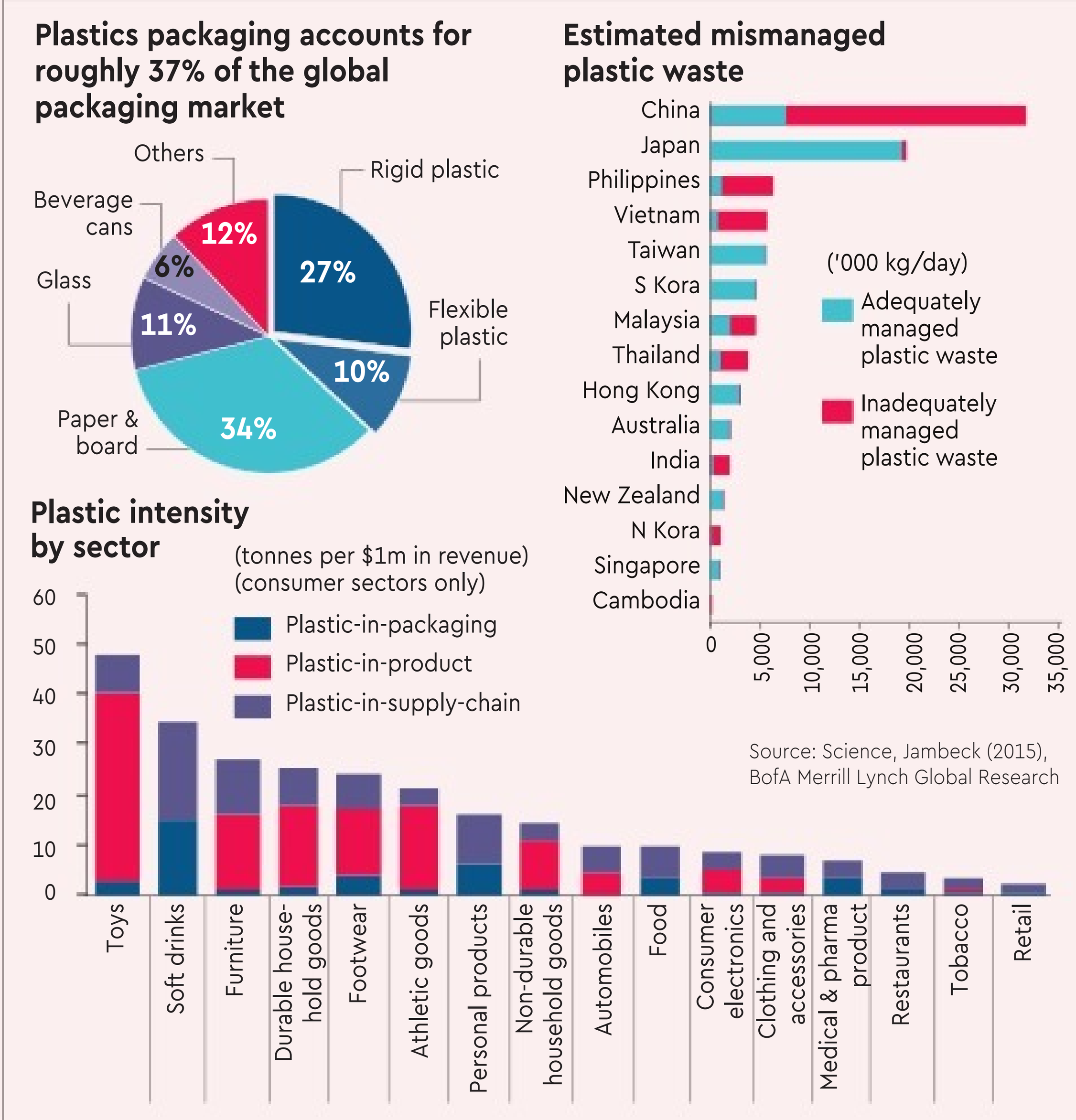
Average waste collection rate across China, Indonesia, Philippines, Thailand and Vietnam is just over 40%. This low vale could be because of—

- Low economic value: 80% of plastic waste has low residual value such as plastic bags. In contrast, the collection rate for higher value PET bottles is 90%. George Staphos notes higher recycling for aluminium cans (55%) as sufficiently high selling prices relative to collection costs, make the economics attractive.
- Poor separation at source: Kerbside collection in Asia Pacific often includes co-mingled plastics with paper, glass and aluminium. Majority of the sorting occurs manually. In contrast, the Lobbe facility in Germany sorts 18 tonnes of packaging per hour, including the ability to handle 20 mm flexibles packaging.
- High rate of pigment contamination: Clear plastics have the highest value and are preferred in the recycling market. Dyed and pigmented plastics contain contaminants and are often disposed rather than recycled.
- Cheaper to dump or export than to recycle: Absent subsidies from the government, it is often cheaper to export and dump plastic waste in landfill. China's recent waste import ban may see the value of plastic scrap fall and encourage further investment in recycling initiatives.

Recent regulatory effort has focused on "no more free plastic bags", extended producer responsibility and consumer waste levies. Australia, Japan and Taiwan have targeted regulatory effort at manufacturers.

In January 2018, China banned the import of plastic waste. Prior to the ban, China imported up to 56% of global exported plastic waste. The largest exporters of waste to China included the US, the UK, the EU and Japan. After China's ban, we are likely to see more stringent plastic waste policies introduced across the globe and in Asia.

We have examined a subset of 41 companies in Asia with exposure to plastic packaging. There is growing acceptance of plastic reduction in these companies. Cut-back in quantity of material per package and use of recycled material demonstrate commitment to plastic waste reduction. Risks are higher for those exposed to "flexibles".




*Edited excerpts from BofAML's ESG Matters-Asia report titled* **Asia's plastic packaging diet: Trimming the "rigids" waste-line**