

Opinion

TUESDAY, FEBRUARY 19, 2019



STOPPING THE VIOLENCE

Mehbooba Mufti, former CM of Jammu & Kashmir

This bloodshed will only stop when the government of India overhauls its approach. Lets drop the obsession with Pakistan and get our own house in order. The current attitude will only worsen the situation and polarise the nation

And now, Google designs chipsets in India

With others like Qualcomm also doing this, India is slowly emerging as a serious player in the tech industry

WHENEVER ELECTRONICS AND IT minister Ravi Shankar Prasad talks of how the number of mobile phone manufacturing units has shot up from just two in 2014 to 123 right now—as a result, the bulk of phones sold in the country will also be made here soon—most point out that these are merely assembly units, and imports from China continue unchecked. While imports of mobile phones fell from \$7.8 billion in 2014 to a likely \$2 billion in 2018, overall imports, including components, shot up by over half, from \$8.8 billion to \$13.3 billion over the same period. Indeed, domestic value addition was just around 10% in 2017 and around 15% in 2018, with the government coming out with a sensible phased-manufacturing programme that increases import duties on a new set of components every year to promote local production.

What can increase domestic value addition quite sharply, of course, is the local designing of chips, even though the fabrication will continue to be done in countries like Taiwan that have fab units. According to a *Reuters* report last week, Google has hired a dozen engineers already to work on designing chips in India, and several more hires are likely. While the chip design at Google is a collaborative effort with the team at its US headquarters, it is a significant step; part of the process at Google to capture more value addition and not be dependent on companies like Qualcomm. How it pans out remains to be seen, but other firms like Qualcomm, Texas Instruments and Intel already have significant India offices with a few thousand engineers working on, amongst others, chip design and R&D. Indeed, Google already has 600-700 engineers working on machine learning and artificial intelligence and has larger plans for its Hyderabad campus which will, eventually, house 13,000 people. At 150,000, IBM's India work force is larger than the one in the US.

And though China beat India in 2018, for two years before that, India was the world-leader when it came to companies setting up Engineering R&D (E-R&D) centres here. According to HFS Research, the total size of the E-R&D business in India—more or less equally split between captives and non-captives—has grown from \$21.8 billion in 2015 to \$26.9 billion in 2017. While China leads in several areas, India continues to lead in aerospace and defence with about a third of all such announcements of centres in 2018 for setting up facilities in India. Indeed, consulting firm Zinnov had projected that, by 2020, India would be home to 1,139 R&D centres with over half a million employees. With firms like SAP and IBM getting 8-10% of their global patents from their centres in India, the Zinnov projections look quite achievable. In the case of a firm like GE, that does a lot of work in India for instance, redesigning its portable ECG machine—in the India centre—helped lower costs from \$10,000 to \$500; the MAC 400 was later scaled up and taken to countries like China, Germany and even the US eventually. The successful completion of the Aadhaar project, and then the building of the IndiaStack applications on top of this, and the rapid and successful rollout of the UPI financial transfers have also helped buttress India's image. Apart from India's engineering talent, the fact that it is seen as a market where there are relatively few issues involving theft of intellectual property, as compared to China, is another attraction. Not bad for a country that, till recently, was not even recognised as a player, even if small, in the global technology space.

EU trumps Big Tech

Copyright rules for Google News *et al* protects publishers, artists

THE EUROPEAN UNION will now insist on stricter copyright compliance from tech companies like Google, Facebook, etc., over use of copyrighted material such as videos, songs, published material on their platforms, including by users. This will give video/music producers and publishers, among other, greater leverage for getting the tech giants to compensate them. Under the new rules, the social media/search giants will be required to apply for a platform licence, and if the artists/producers/content creators refuse to grant this, firms will have to take down unlicensed content already present on their platforms or attempt to block uploads. Similarly, they will be required to negotiate licences with publishers or get the latter to waive off their rights, else they can't display news snippets under headlines. With much of advertising revenue that newspapers depended upon shifting to digital media, established newspapers faced unprecedented pressure online with news-aggregation services and social media becoming the new competition. On the other end, smaller publications/websites were only too happy to have the tech firms direct traffic their way, helping them get attention from advertisers.

Free speech activists also joined the fray, saying that the new copyright rules could result in censorship, where the pretext of copyrighted content could be used to stifle "inconvenient truths". However, the need was to recognise that 'Big Tech' companies have benefited from displaying news articles without investing in journalism. Under the final deal, 'Big Tech' firms can be held to account and will not get a free run in benefiting off original content creators/producers/publishers. The new rules safeguard the interests of users of various platforms by putting the onus of negotiating licence-granting on the platform. They also overcome some of the fault lines within the publishing community—publishers who need the traffic generated through Google News can agree to waive off licensing requirements. Big Tech is also partially protected with press content of more than two years excluded from the licensing yoke. The rules also allow for unlicensed hyperlinking of individual words or very short extracts, and by doing that, the internet ecosystem that depends on a slightly relaxed copyright regime for flourishing also gets some manner of protection. Also, tech firms won't be automatically held responsible if unlicensed, copyright-protected material appears on their platforms if they make the "best efforts" to prevent the content's availability on their platforms. Platforms with annual turnover of less than 10 million euros, having less than 5 million monthly active users and not more than three years old, are exempt from having to ensure that unlicensed copyright-protected material they have removed doesn't appear online.

To be sure, some critics argue the rules will hinder organic growth of the internet as tech firms get increasingly concerned with content filtering, which itself may not always be perfect and block legal uploads. But, the larger consideration here is that the creative and the publishing industry can't keep losing revenue to a YouTube/Facebook or a Google News.

Parental Control

Absher's removal will not delete or change the oppressive laws that continue to restrict and bind women

OVER THE PAST week, Apple and Google have been severely criticised for offering a Saudi Arabian government application called Absher on their respective app marketplaces. The application, launched in 2015, facilitates the ease of access to Saudi-government provided services by those within the country and reduces inefficient bureaucracy in day-to-day government functions. However, the application also lets men restrict the movement of women under their guardianship system. And the only reason why the application is making headlines right now, despite it being launched four years ago, is the increased international scrutiny on Saudi Arabia following the Jamal Khashoggi murder and the Rahaf Mohammed case, in which a Saudi teenager successfully managed to escape the clutches of the dreaded guardianship system and get asylum in Canada.

The increased coverage that the country's repressive gender laws are receiving is indeed good news, but a majority of the reporting concerning Absher also lacks recognition of the other side of the story. *The Guardian* cited a tweet from a Saudi woman explaining that, while the application facilitates the tracking of women, it also reduces the time needed to file visa papers for women who do get to travel—a reasoning that was used to further restrict women before. That said, even if it does serve an important purpose, a waiver can be presented in many non-digital but verifiable forms—even if this comes at the cost of some more time consumed, it is still preferable to a scenario where the app can be used to track women's movement. The 'dilemma' over Absher's positive fallout isn't really a problem, given the workaround. But attacking an app will be of no help. What is needed is eliminating the unjust practices that continue to marginalise and harm women and social and political reforms that bring an end to the deep-rooted patriarchal understanding of women's position in social hierarchy that Wahhabism promotes.

THE FROWN CURVE

GROWTH WILL LIKELY CONTINUE TO DISAPPOINT IN THE NEAR-TERM AS EFFECTIVENESS OF RECENT POLICY EASING WILL BE PARTIALLY LOST DUE TO TRANSMISSION LAGS AND IMPLEMENTATION HURDLES

Why politics and economics don't always smile

WITH GENERAL ELECTIONS scheduled for April and signs of the tide turning against the ruling BJP, the drumroll of populist policies has intensified over the past six months. While strong macro-fundamentals can accommodate these populist excesses in the short-run, they risk creating imbalances in the medium-term, with implicit prioritisation of consumption over investment. In addition, stimulus during times of economic calm often comes at the cost of crucial policy space needed in the future when the downturn becomes entrenched. Consider the following: the BJP-led National Democratic Alliance (NDA)'s rule during 1999-04 was marked by stable macros of low inflation and favourable external sector dynamics.

However, deteriorating rural terms of trade was one factor that resulted in its electoral defeat in the 2004 elections. The first term of the Congress-led UPA government during 2004-09 marked a reversal in rural fortunes and a return of the UPA government in 2009—likely due to the 'just right' mix of prudence and populism. However, as rural deflation and fiscal excesses triggered inflation, real rural incomes declined and, along with corruption scandals, ousted the UPA in 2014. The macro backdrop today seems eerily similar to 2004. Banks had large NPAs during 1999-04, as they have had during 2014-till now. The BJP MSP and food inflation low then, as now. Rural income growth was low then, as it is now.

At a national level, the experience of the last two decades suggests an inverted-U (a frown) relationship between the degree of populism (defining this pre-

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dominantly as rural reflationary policies) and the electoral success. Too much populism as well as too little populism (too much prudence) have both resulted in an electoral defeat. The trick is finding the right balance between prudence and populism. Policies around rural India have played a big role in deciding the electoral outcome, as rural India accounts for ~70% of the total population.

The broad direction of macro policies in India is moving towards more accommodation. The triggers are both political and economic. On the fiscal front, the Central government's fiscal deficit has remained in the 3.4-3.5% of GDP range since FY17 (year ending March). To appease the farm sector, the government announced an income support programme for landholding farmers, which carries the bearings of a perpetual scheme, rather than a one-time cash transfer. This follows the government's poor decision to raise MSP by at least 1.5-times the production cost in 2018. Other social welfare commitments—health care, pension for unorganised sector—currently don't entail large monetary allocation, but will likely incur higher expenses in coming years. In the absence of higher goods and services tax revenues, this suggests an upside risk to the future fiscal deficit path. On the monetary policy front, changes

are more subtle. With average headline inflation below 4% since 2017, this had resulted in higher realised real rates. In his maiden monetary policy statement, the RBI Governor, Shaktikanta Das stated that the surprise rate cut in February (notwithstanding high core inflation) was a result of low headline inflation and that, once the price stability objective had been achieved, RBI would address the objective of growth. It indicates a higher weight being assigned to headline inflation (relative to core) and to growth. This possibly signals lower realised real rates in the coming years. On the regulatory front, RBI has eased risk-weight norms for non-bank finance companies due to the shadow banking crisis. Three public sector banks were taken out of the prompt corrective action (PCA) framework in end-January. It also permitted a one-time restructuring of existing loans to Micro, Small and Medium Enterprises (MSMEs) that have become stressed. Report of the expert committee on economic capital framework is also awaited on whether the RBI holds excess reserves on its balance sheet.

Accommodative macro policies do not necessarily imply imprudence. If growth is weak, then counter-cyclical macro policies are essential. At the same time, we believe it is essential for policymakers to halt when pragmatism starts to morph

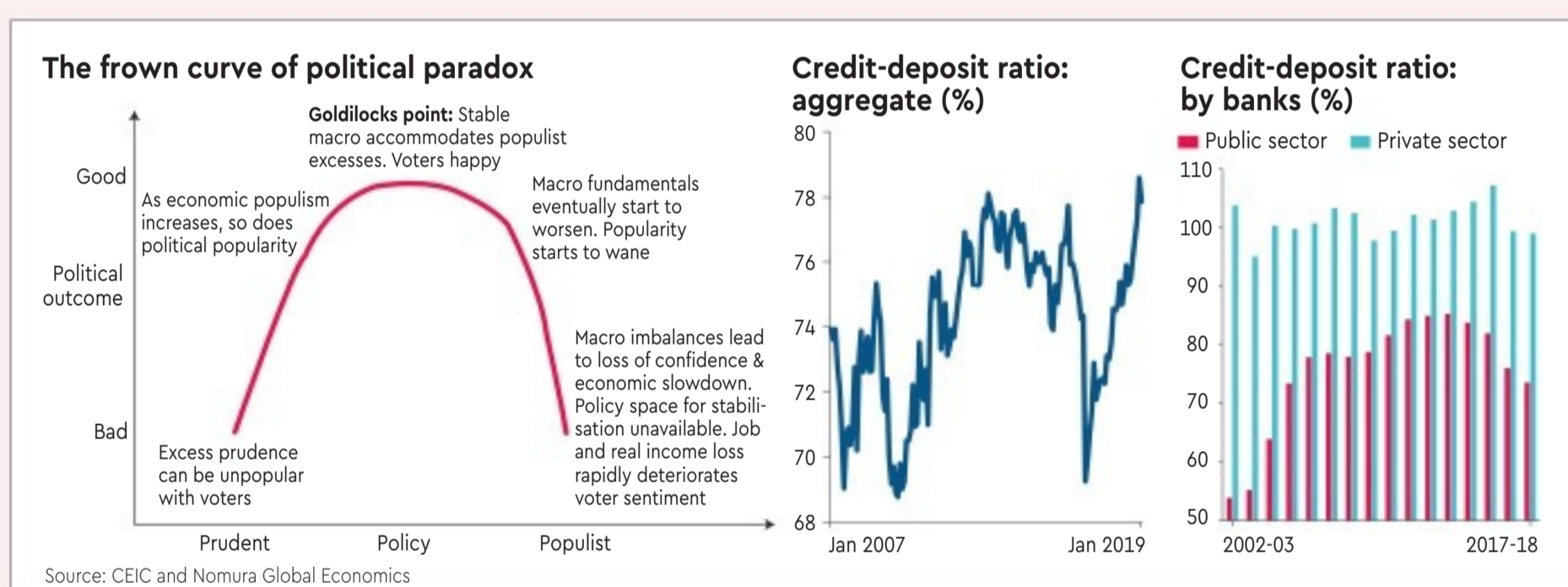
into imprudence. Many small steps could cumulatively create the foundations for future instability. For example, ensuring adequate liquidity for non-bank finance companies is essential to prevent a liquidity crisis from morphing into a solvency crisis; but too much liquidity is also a bedrock of future inflation. Forbearance only kicks the can down the road.

In the short-term, the effectiveness of recent policy easing will be partially lost due to transmission lags and implementation hurdles. The farm package will likely encounter implementation challenges because not all states have computerised land records; those that do, don't necessarily have accurate records; and many states do not have bank accounts linked to these land records. Similarly, the impact of RBI's rate cut will be delayed and uneven. Banks that have the capacity to lend are already garnering market share from shadow banks (after last year's crisis) and hence have elevated CD ratio/tighter liquidity constraints, which will delay any reduction in lending rates. In addition, some sectors, such as the low-tiered shadow banks, are credit-constrained because of the perception of higher 'credit risk' and may not benefit from the rate cuts as much. Retail lending, on the other hand, continues to benefit.

The global backdrop (weak global demand), lagged impact of tighter credit conditions due to the shadow banking crisis and a likely slowdown in investments due to political uncertainty implies that growth will continue to disappoint in the near-term, despite domestic macro policies turning accommodative. Predictions are that GDP growth will slow down from 7.1% y-o-y in Q3 2018 to 6.6% in Q4 and further to between 6.0-6.5% in H1 of 2019.

Low global food prices and domestic balance sheet constraints also imply that there is no imminent inflationary risk. Weak growth and lower cost pressures should moderate core inflation. RBI's more optimistic growth projection amid below-4% inflation will support a further rate cut. Pencil in a 25 bps rate cut in Q2 (most likely in April) and attach a 20% chance to one more in Q3. Expect GDP growth to pick-up to slightly above 7% by end-2019 and into 2020.

Edited excerpts from Nomura's Asia Insights India: *'The Frown curve'—why politics and economics don't always smile* (February 14)



Will small e-wallet players survive?

In order to encourage healthy competition, RBI must either remove the stringent requirement of full KYC compliance or provide for a cost-effective method to complete it

PROBIR ROY CHOWDHURY & ARCHANA TEWARY

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AS THE DEADLINE for mandatory requirement of completing KYC compliance for all users of e-wallets approaches, it has left many to ponder if this would be the end of the road for several e-wallet companies in India, and puts the users of e-wallets in a quandary.

The requirement of completing full KYC can be traced back to October 2017, wherein RBI issued a circular mandating all e-wallet entities to complete full KYC of their wallet users by December 2017. However, several prepaid payment instruments issuers expressed their difficulty in complying with this requirement and RBI accordingly extended the deadline to February 28, 2018. Now, as a final extension, RBI has made it mandatory for all prepaid payment issuers to complete full KYC of all its customers before February 28, 2019, failing which customers' e-wallets would become non-operational. While the deadlines have been extended, little has been done to address the issues raised by e-wallet issuers.

This mandatory requirement poses a threat to e-wallet issuers, especially small players among the e-wallet participants, in terms of continuity of business. After the Supreme Court's judgment on 'Aadhaar' in *Justice KS Puttaswamy and Ors. v. Union of India*, corporate entities are no longer allowed to use Aadhaar's biometric identification for KYC verification and RBI is yet to provide an alternative method for e-KYC. As a result of this, e-wallet issuers are finding it very onerous to complete KYC verification, since the only available method now to complete KYC of customers is by conducting physical verification. Companies with resources to do so are rushing to comply

with the deadline by relying on physical verification. However, for the small players in the e-wallet market, pursuing physical verification on such a large-scale, would not only be difficult but also very expensive. This could result in these small players exiting the market on account of huge costs.

Further, physical verification of KYC creates several limitations on the collecting entity, some of which include incorrect details being updated into the system and documents being misplaced. Additionally, India is yet to implement stringent measures to tackle issues pertaining to privacy and security breach of data. A full KYC verification would mean collecting customers' personal data and subjecting such data to the risk of being compromised.

It is also likely that customers will be hesitant to complete their KYC with each e-wallet company separately on account of the process being cumbersome. This may result in existing e-wallet customers to only maintain accounts with a few e-wallet companies (preferably with the big players) instead of holding multiple e-wallet accounts, which may cause small players to exit the e-wallet market. Further, several smaller wallets are often ancillary to the services provided by e-wallet issuers and offer operational convenience to users of those services. Such users could also benefit from discounts or other operational conveniences provided by such companies which have integrated e-wallets into their application. Suspension of e-wallets could thus have a broader impact on users as well.

E-wallet players also have the additional worry of customers choosing UPI over e-wallets as a digital form of pay-

ment. In 2016, the National Payment Council of India introduced UPI, a system which enables bank account holders to transfer funds through the Immediate Payment Service (IMPS) using a virtual payment address. UPI does not have to comply with full KYC requirements of customers since banks have already completed the KYC verification of its customers. In this regard, customers are slowly moving towards making digital payments on UPI rails due to ease of transferring funds and non-requirement of additional KYC verification. Considering this change in market preference, e-wallet players will be compelled to integrate UPI as one of their payment systems, in order to remain relevant in the market.

For an economy which is increasingly moving towards digital transactions, it is critical for laws to support and nurture fintech companies since, otherwise, the smaller companies will have no option but to shut shop. An example of this was when several P2P lending platforms in China shut operations as these entities found it difficult to comply with the strict regulations imposed by the government. Therefore, in order to encourage healthy competition and provide options to customers, RBI must either remove the stringent requirement of full KYC compliance or provide for a cost-effective method to complete full KYC. Is the government driving out competition and creating a monopoly by ensuring that the UPI platform is the preferred platform? We believe it is time for the regulators to sit up and act.

Written with inputs from **Kavya Katherine Thayil**, an associate at J Sagar Associates

LETTERS TO THE EDITOR

Shadow of death in the valley

There is no guarantee that military action will prove efficacious in curbing militant attacks. The sub-continent cannot be turned into a theatre of war. The intractable territorial dispute is not amenable to a military solution. It is a geopolitical problem involving religious and cultural identities and requires a political solution through dialogue. It must be conceded that militancy is rooted in the political grievances of the disaffected and alienated Kashmiri people. The sad truth in the valley is that the security personnel and militants lose their lives in the fight between them. Violence and counter-violence and killings and counter-killings get us nowhere. Statesmanship and sagacity, as against jingoism and bellicosity, are what is now needed from all sides to bring about a semblance of normality and peace in the Himalayan region — G David Milton, Maruthancode

Details of calls

Mobile phone service providers turn down requests made for details of 'incoming' and 'missed' calls on mobile numbers of the person/s making such a request in the name of 'privacy', while companies are providing details of 'outgoing' calls. Providing details of 'incoming' and 'missed' calls on request is of utmost importance in cases of obscene or threatening or harassing or fraud calls. TRAI should make it mandatory for mobile service providers to provide details of 'incoming' and 'missed' calls in the manner they provide such details of 'outgoing' calls — Madhu Agrawal, Delhi

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UNIVERSAL BASIC INCOME (UBI) in its pure form implies six essential ingredients. It is universal, individual, cash, monthly, unconditional and lastly it is a right that cannot be withdrawn. As a full-fledged social policy, it has not been implemented anywhere in the world yet. In the last decade, suddenly there has been an explosion of interest in the idea—in the universities, mainstream media and policy corridors. Political philosopher Karl Widerquist of Georgetown University calls the current wave of enthusiasm and activism as the *third wave*. The first wave was between 1910 and 1940 and the second one in the 1960s and 1970s, he observes. While the earlier waves had been sporadic, the current one seems to be the longest one.

By 'universal', we mean that all residents of a particular territory of a nation state are entitled to a basic income simply by virtue of being a resident of the territory. Being universal has two important advantages. One is administrative efficiency. Income transfer bypasses all the limitations posed by the errors of targeting. In India particularly, we have not been able to resolve the question of targeting. Most of our welfare programmes suffer from both inclusion and exclusion errors. The second advantage is called the 'solidarity effect'. By giving everyone, UBI ceases to be a welfare scheme or a subsidy and all the stigma, paternalism and disapproval that are attached to it. Pragmatic questions remain whether we can afford it, but we will come to that later.

By 'individual', we mean that every single individual—adult or child—is entitled to a UBI, as opposed to giving it to the household. This aspect of UBI accords economic citizenship to each and every individual and this is said to have the 'empowerment effect'. Individuals are empowered because entitlement to UBI provides individuals a sense of worth and the protects individual freedom. On the contrary, if UBI is given to the household, a woman who is living in a household, a woman who is forced to continue in it just to have basic income security.

By 'cash only', we mean that it should not be in-kind transfers. It should be cash only, and should be delivered efficiently to the individuals and ought to be leak-proof. Today's technology allows this kind of direct transfer.

By 'monthly', we mean that UBI should be given every month so that people have a regular, predictable and reliable income stream. This has strong implications for the rate of *time preference* of the poor. In general, the rate of time preference of the poor households is very high, which means that they tend to focus on the present rather than on the future. In other words, what they earn they are forced to consume in the present rather than have any kind of future orientation in terms of savings or investment in human capital. When they experience a regular income stream, this changes substantially, and they tend to develop a future orientation—which means that they begin to balance their current consumption and investments for the future.

By 'unconditional', we mean that there should be no conditions whatsoever—*ex ante* or *ex post*. That is, neither conditions related to eligibility to receive basic income (age, gender, income level, etc) nor conditions related to demonstrating specific behavioural compliance or an output (school attendance, number of vaccinations taken, repayment of loans, etc). In general, most welfare programmes in India are conditional in nature and their continuation is controlled and regulated by a vigilant welfare bureaucracy. Conditions are paternalistic and humiliating, and they challenge the potential recipients to prove that they deserve the support.

By 'right', we mean that basic income ought to be given to people as a matter of right and not a scheme that



ILLUSTRATION: ROHINIT PHORE



The author is vice-chair, Basic Income Earth Network, and coordinator, India Network for Basic Income

Basic income: The idea and Indian experiments

UBI has the potential to provide a sense of security to individuals and households; to provide all the members of the society safeguards against the vagaries of market forces; and to give individuals the freedom to say 'no' to certain things and, equally, to say 'yes' to certain other things in their lives

can be withdrawn at any time or given as a temporary relief to cope with a calamity.

Theoretically, the efficacy of UBI is discussed assuming it is implemented with all the above characteristics. It is in this combination that UBI gains the potential power:

- to provide a sense of security to individuals and households;
- to raise the floor and provide all the members of the society a ground to stand on—and then build their lives on that foundation navigating through the vagaries of market forces;
- to enable individuals to possess the freedom to say 'no' to certain things, and equally to say 'yes' to certain other things in their lives.

Indian experiments

In India, the Self Employed Women's Association (SEWA) with the support of the UNICEF had conducted two experiments in Madhya Pradesh between 2011 and 2013. The first experiment was done in eight regular villages and the second in a tribal village. These experiments strictly adhered to the model described above. The transfers were:

- 'universal' within the village, which means all the residents of the village—

In the SEWA-UNICEF pilot in Madhya Pradesh, it was seen that food sufficiency farmers, small and marginal farmers spent more time on their farms, livestock nearly doubled, and women started new enterprises

rich and poor—received the basic income;

- the entitlement was 'individual';
- 'cash' was either transferred to a bank account or, in the case of the tribal village, given directly to individuals;
- it was given to them 'unconditional';
- it was completely 'unconditional'; and finally,
- it was a 'right' since everyone was entitled to the basic income for the entire duration of the experiment, and even when a child was born during the experiment he/she was automatically added to the list of recipients.

In regular villages, each adult was paid ₹200 per month for 12 months, which was increased to ₹300 when the transfers were extended by five more months. In the tribal village, each adult was paid ₹300 for a period of 12 months. Children were paid half of that amount and money was transferred to their mothers' accounts.

The results of the experiment were extremely positive. Food sufficiency improved, small and marginal farmers spent more time on their farms and the result was that more land was brought under cultivation and agricultural production has increased, livestock nearly doubled, women started new enterprises, for smaller borrowings people moved away from the moneylenders to neighbours and relatives, and some people shifted away from more exploitative forms of employment to less exploitative ones. The liquidity that people enjoyed during the experiment empowered them and enabled them to make choices that turned out to be positive and emancipatory.

These positive results, it seems to me, can be primarily attributed to a *gestalt effect* caused by a convergence of different elements of the experiment rather than because of the simple act of injecting cash into the household. The overall effect of a regular basic income was truly transformative. The emancipatory value, it appears, was several times greater than the monetary value of the transfers both because of the convergence of the design elements and also cumulative effect over time.

(This is the first of the two-part series.)

Macroeconomic impact of uncertainty

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During 2012-18, did uncertainty play any role in influencing the movement of the multiple economic variables?

THE PERIOD OF UNCERTAINTY (after an economic shock or the fear of occurrence of the event, rather than the occurrence itself) can have a substantial impact on various economic variables by altering the decision-making behaviour of individuals at the macro or micro level. The economic shock here refers to any economic policy (monetary or fiscal), regulation changes, any decision taken by the central bank, policymakers or the government, or any unexpected economic development.

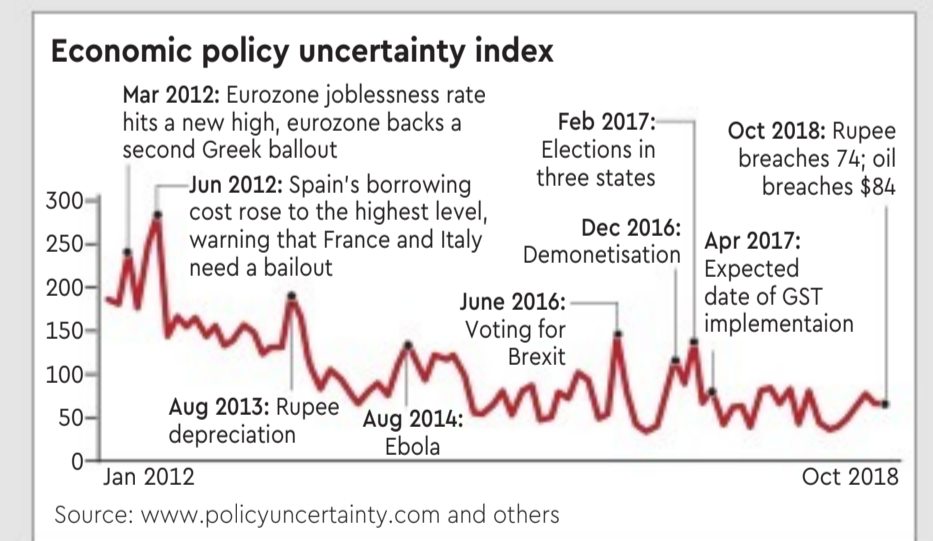
Although there has been significant research on the impact of uncertainty on economic variables, it was not until the recent financial crisis that it began to be widely researched and quantified. Several research papers have provided evidence on how increased uncertainty has made a noticeable impact on real activity in various countries. This is of particular importance to policymakers. For any policy decision to be effective, it becomes relevant that the potential benefits are rightly understood by the group of individuals for whom the policy is designed for or the nation. Any uncertainty caused by the news of a policy decision might make it difficult to implement effectively and/or negate the positive outcomes to an extent. An example is the recent demonetisation and the implementation of GST, which created huge uncertainty and impacted the Indian economy.

It has been well-documented how uncertainty, regarding financial crises, has impacted the growth path of various countries globally, including India. For example, uncertainty explained part of the collapse in global economic activity in 2008-09 (Stock and Watson 2012) and of the sluggish ensuing economic recovery (IMF 2013).

During 2012-18 (till September 2018), did uncertainty play any role in influencing the movement of the multiple economic variables? We looked at the impact of economic policy uncertainty (EPU) shocks on Indian macroeconomic variables such as index of industrial production (IIP), retail inflation, short-term money market rates, stock market, the rupee, and imports using Impulse Response Function (IRF). As a measure of uncertainty, we have considered the EPU index developed by Baker et al (2013)—a news-based economic policy related uncertainty index for major economies around the world, including India. The accompanying graphic plots the uncertainty index and the various shocks that impacted the economy during this period.

It was found that the duration of the response in industrial production against the uncertainty shock lasted for about eight months before returning to long-term equilibrium level. Uncertainty caused significant changes in the initial few months, and a large impact in the third month. An impulse in uncertainty at time zero had a negligible impact on retail inflation or CPI; it impacted the most between first and second months, but the effects of the shock completely dissipated around the fourth month. It has also been found that uncertainty explained only 0.67% of the variation in CPI in the first month. An impulse in uncertainty on 91-day treasury bills at time zero had a maximum negative impact in the second month and became positive in the fourth, but started to taper off from then onwards.

Interestingly, for the stock market, an impulse in uncertainty at time zero had a maximum positive impact in the second month, which then started to taper off from the fourth month. One standard deviation shock in uncertainty causes a significant change in the rupee for three consecutive periods and it took seven months for the rupee to return to its equilibrium level. Further, one standard deviation shock in uncertainty caused a significant impact on imports during the first month and the impact of the shock lasted for six months before returning to equilibrium.



SINGAPORE VCC

A game-changer for FDI in India?

Singapore's VCC development for investment fund industry investing not only in India but the whole of Asia-Pacific region

MAHIP GUPTA & KUSHAL PARIKH

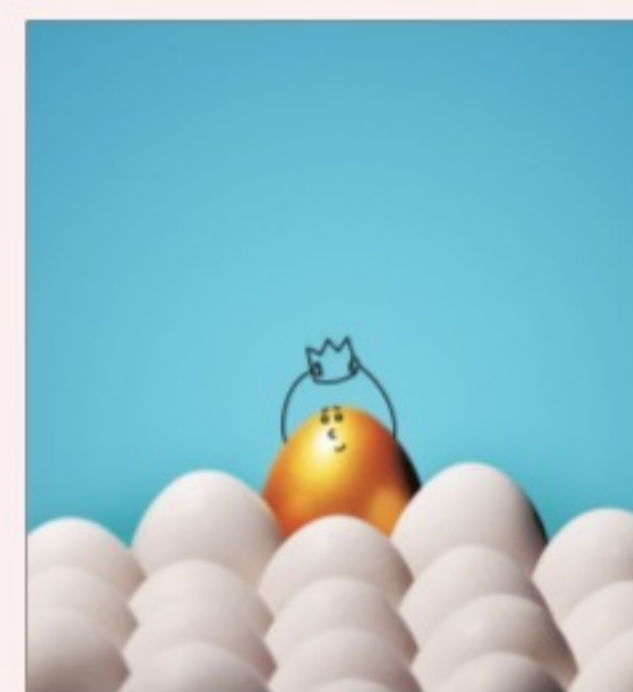
Authors are with Dhruva Advisors LLP

the following additional flexibility:

- It can make distributions to shareholders out of its capital even if it has no profits or reserves;
- Its shares could be regularly redeemed or bought back without seeking shareholder approval each time;
- The value of its paid-up capital is always deemed equal to its NAV—its shares must be issued, redeemed and repurchased at such NAV; and
- Apart from different classes of shares, VCCs can also issue debentures and bonds, which could be listed on stock exchanges;

VCCs can be set up as a single stand-alone fund or an umbrella fund. While a stand-alone fund enjoys all the above features of the VCC framework, an umbrella fund has additional advantage of creating two or more sub-funds whose assets and liabilities are completely segregated, i.e. losses of one sub-fund will not impact NAV of any other sub-fund.

An umbrella fund structure would help a large fund manager attain economies of scale by saving operational and compliance costs associated with setting up multiple corporate vehicles.



The taxation framework

For tax purposes, a VCC will be treated as a single entity, i.e. in case of an umbrella VCC, sub-funds will not need to undertake separate tax compliance. Further, a VCC should be eligible to access Singapore's tax treaty network where it is considered as a Singapore tax resident based on its 'control and management' in Singapore.

As regards incentives, a VCC will be eligible to apply for tax exemptions available to other funds managed by a Singapore-based fund manager. Such exempt VCCs will also be eligible for GST remissions

reducing the Singapore GST incidence on management fees to a small fraction. Fund managers will be eligible to apply for concessional tax rate of 10% in respect of their fees from VCCs.

Re-domiciliation of existing overseas funds in Singapore

The existing offshore fund as a framework similar to a VCC will be permitted to be re-domiciled in Singapore. Where the overseas fund is not structured similar to a VCC, then restructuring may be explored prior to re-domiciliation.

This feature is expected to give further boost to local domiciliation of investment funds in Singapore.

VCCs in Indian context

While the India-Singapore tax treaty has been revised to do away with the tax exemption of capital gains on sale of shares of an Indian company, the treaty still offers grandfathered exemption for cash equity investments made up to March 31, 2017 (irrespective of when such investments are sold). Further, it continues to exempt gains from other financial instruments (i.e. bonds, debentures, derivatives instruments, etc).

However, the existing Singapore funds with fewer/pooling vehicles outside Singapore could face challenges on the eligibility of the India-Singapore tax treaty benefits due to introduction of Indian General anti-avoidance rule (GAAR) provisions effective from April 1, 2017, and the proposed introduction of treaty anti-abuse provisions under the Multilateral Instrument (MLI).

The VCC framework provides an effective way to deal with the above challenges to investment funds. Once the framework is effective, fund managers will be able to pool funds in Singapore itself. Further, the VCC will have a Singapore-based investment manager, custodian, administrator, etc. This will significantly strengthen the commercial substance for investment funds and strengthen the case for treaty access in this post-BEPS era. One may also explore re-domiciliation of existing offshore pooling vehicles to Singapore with the similar intention for realignment with commercial substance.

The introduction of the VCC framework in Singapore is a significant development for the investment fund industry investing not only in India but the whole of Asia-Pacific region. Specifically from an India point view, clearly the VCC regime could prove to be a game-changer.