

Opinion

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SAUDI-INDIA COOPERATION

Narendra Modi, prime minister of India

Last week's barbaric Pulwama attack was a symbol of the shadow of the inhuman danger hovering over the world. To deal with the scourge, we have agreed that there was a need to ramp up pressure on countries extending any sort of support to terrorism

ANGEL TAX

BY ALLOWING LISTED FIRMS TO DO ANGEL INVESTMENT, A BIG WINDOW FOR POTENTIAL FUNDS HAS BEEN OPENED UP, AND THAT WILL BENEFIT BOTH THE BIG FIRMS AND START-UPS

Indian firms can finally act like angels

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NOT SINCE THE launch of 'Start-up India' in 2016 has a single notification from the government garnered so much praise from Indian entrepreneurs. The recent notification from DPIIT (formerly DIPP) signalled the death knell for the dreaded 'Angel Tax'—section 56(2)(viib) of the Income Tax Act, 1961. The section taxed capital receipts from Indian investors as income in the hands of private companies based on "high" share premium, a taxation approach unique only to India. It also applied only to investments from Indians and not foreigners—an act of discrimination which has seen domestic funding shrink 48% from 2015 and had led many to dub this the 'Indian Tax'.

The notification, borne out of roundtables organised by Ramesh Abhishek of DPIIT on February 4, was a refreshing change of pace as it crowdsourced a solution from Indian entrepreneurs as opposed to deciding what was best for them. Some of the measures include: -

- A ₹25 crore blanket exemption for money raised from any Indian source

- Extending the tenure and revenue threshold to 10 years and ₹100 crore in order to qualify as a start-up

- Allowing investments from listed companies to be exempt from the section

But it is the last point around listed companies that is the single biggest game-changer for Indian start-ups.

Every start-up ecosystem in the world thrives when its large listed companies invest heavily into the ecosystem. Silicon Valley owes a lot to listed companies like Google, Facebook, Salesforce, Microsoft, etc., who have

invested billions of dollars into start-ups and are amongst the largest acquirers of start-ups there. China's Alibaba, Tencent and Baidu are renowned for creating start-up clusters as well. The best example of this comes from the Didu-Uber wars in 2016.

When Uber raised \$2 billion to specifically invest in China, Jean Liu, the president of Didi Chuxing, the largest cab-hailing service in China, went straight to Tencent and Baba to get the capital required to take them on. In the words of Yanbo Wang, Chinese academician who studies start-ups, "for Uber, burning through \$2 billion in China was a huge amount. But for Didi, and for TenCent and Alibaba, spending \$2 billion to win at home? It was nothing". Which Indian entrepreneur can boast the same of an Indian company giving him or her the capital to take on a global behemoth?

The top 10 listed companies in India are sitting on cash and cash equivalents of over ₹2.7 lakh crore, which is around \$38 billion. Contrast that with the \$38.5 billion raised by all Indian start-ups from 2014 to 2018, of which not even 10% comes from Indian sources, and you can see how

our listed companies have failed the start-up ecosystem. Companies like TCS, Infosys, Indian Oil, are buying back crores of stock—an indication that the company believes that the money is better returned to investors as opposed to being invested by the company—belies the sheer potential that remains untapped.

But no longer. This 'Angel Tax' prevented listed companies from investing in start-ups as their investments would have been liable to being taxed in the hands of the start-up. Due to stringent norms regarding the reporting of the fair value of all investments, this tax amount impaired the value of the start-up and directly hit the bottom-line of the listed company. But after this exemption given to them, their reluctance to immerse themselves into the Indian start-up system should subside.

Make no mistake, India will not become a digital colony unless we have more active participation from domestic pools of capital. Our listed companies are sitting on piles of cash and, yet, their acquisitions of and investments into Indian start-ups are paltry. While the rest of the world is

looking at the Indian start-up ecosystem to invest or acquire, why are our largest home-grown heroes still looking abroad? Though our listed behemoths never received venture capital funding and bootstrapped themselves till they listed, the rules of the game have changed. The capital scarcity affecting Indian companies is no longer there—what we are suffering from is domestic participation.

The recent circular will undo close to seven years of harm caused by this faulty policy. The remaining issues around companies who have received notices of not being able to seek relief under the circular, start-ups being unable to create subsidiaries or JVs or acquire another for stock due to self-declaration and the issue around section 68, which claimed two companies, will be redressed shortly by CBDT. Several organisations and people who fought for this, including I, are already working towards this actively and the government has promised us support.

At long last, the restrictions on domestic capital pools have been lifted and the notion of taxing valuations and share premium is being done away with. Indian entrepreneurs have been put on par with their global peers and local laws will no longer hinder their journey. As much as the media and founders are rejoicing, I hope India Inc will start looking at start-ups more seriously and invest into the ecosystem.

To paraphrase Raj Kapoor from *Shree 420*,

*Mera juta hai jaapaani,
ye patlu ingalistaani
poora capital hai amricani
phir bhi dil hai hindustani*

Hopefully, our capital can once again become *desi*.

Pledged shares and real estate loans are worrying

Falling value of pledged promoter shares and the ability of real estate firms to repay NBFCs is the next big worry

THE SOMEWHAT RECKLESS lending by NBFCs to promoters against shares of their companies is bound to take a toll on their balance sheets. Indeed, what is shocking is the nonchalance with which mutual funds—which are supposed to be investing the savings of small investors—have also lent to promoters against pledged shares. As share prices fall, and lenders sell the pledged shares in the market, they are becoming more vulnerable to losses. Some NBFCs are monetising other businesses to ensure their cash flows are not choked. Indeed, it is not clear whether mutual funds understand the risk associated with lending against equity shares. The fact is, smaller companies today are short of cash—since business isn't exactly booming—and promoters are resorting to leveraging themselves. While the funds are being invested in their businesses, the practice is nonetheless worrying. Axis Capital has pointed out that the aggregate pledging activity by promoters within the BSE 200 hit an eight-year high in the October-December quarter.

The next big worry for the financial markets is how real estate players are going to service their loans; the mix of developer loans in total NBFC/HFC credit has inched up from 6.2% in 2014-15 to 10.7% in 2017-18. By all accounts, that share would have moved up further by now. Developers are in a tough situation due to sluggish sales, high unsold inventories, lengthening project lifecycles and slower price correction that has left affordability low. Some of these problems were hidden by the easy refinancing, but the severe shortage of liquidity over the past six months changes the situation completely. The liquidity deficit in the banking system shot up to nearly ₹87,000 crore in the week to February 15, the highest in seven weeks. While this may ease over time, the high level of borrowings by the Centre, states and PSUs is threatening to crowd out the private sector. The total value of developer loans is estimated at ₹6 lakh crore; of this, the vulnerable portion, which is the core developer book, is estimated at ₹3.4 lakh crore, or 60% of the total according to Credit Suisse. While this portfolio grew at just 4% for banks between 2014-15 and 2017-18, it grew at a whopping 46% for NBFCs/HFCs. As such, even a little bit of stress could have a big impact in the money markets.

To some extent, the forbearance extended by RBI on real estate loans, around seven years ago, is to blame. Since banks were allowed to restructure loans to builders, the developers were not forced to offload inventories at market-clearing prices. Even otherwise, the real estate business was on a sticky wicket since much of it was investment-driven and based on the premise that prices would trend higher. For their part, the developers used the collections from pre-selling apartments to buy more land instead of completing projects. The result is around 4 lakh units of inventory in India's micro-markets and large dues to banks. By a conservative estimate, this amounts to around ₹2 lakh crore of liquidity. Today, buyers are unwilling to purchase homes in the expectation prices will fall and, so, inventories are getting cleared at a very slow pace. The chickens are coming home to roost.

A little more angelic now

Over a year to fix the issue, but no relief for existing cases

WHILE THE GOVERNMENT has done well to finally address the issue of taxing angel funding, the long delay—and the series of twists and turns in between—speaks volumes for how a reluctant tax department managed to put off a solution for well over a year. And this is despite the fact that start-ups are a personal passion of prime minister Narendra Modi who even got the government to set up a fund to help catalyse investments into these start-ups. Indeed, with the areas the start-ups are working in like fintech/health-tech/agri-tech/etc., and the possibility of providing radical solutions, these start-ups have already created a lot of value for investors. According to Inc42—a media platform dedicated to the start-up ecosystem—between them, India's 39,000 start-ups have got a total funding of \$38.5 billion since January 2014 and are, today, valued at around \$130 billion.

So, when matters came to a head and surfaced in the media, and the government said there would be no harassment till a committee came up with a solution, the taxman continued to issue notices and, in one case, the start-up said the taxman had even attached its bank account and withdrawn money from it. And when those protesting against the tax on angel funding ratcheted up the protest, the taxman issued clarifications that were niggardly and didn't really address the issue. So, for instance, when no tax was to be levied if the start-up had a capital of under ₹10 crore, this low cap limited the scope of angel funding. And since the exemption applied to angels who had an income of over ₹50 lakh and a net worth of over ₹2 crore, this effectively ruled out investments from friends and family that probably represent a fifth of all angel investment. By saying investment up to ₹25 crore in start-ups will now be exempt, the friends-and-family issue has been sorted out; start-ups can now have a capital base of up to ₹100 crore in place of the earlier ₹25 crore and any listed firm—with a turnover of at least ₹250 crore and a net worth of ₹100 crore—can also act as an angel investor without the money being taxed; funding by big local firms can be a big source of investment as it is in other countries.

To ensure the solution works, the government must now monitor tax demands to ensure the taxman doesn't still try to catch angel investments under the ambit of Section 68 of the I-T Act; so, as long as the start-up furnishes the PAN numbers of investors and all payments are made by cheque, that has to be good enough. The taxman is under pressure to ensure that shell companies don't masquerade as start-ups, so the temptation to have stricter norms in practice needs to be guarded against. Also, the stipulation that the start-up can't invest in shares will ensure no start-ups can merge or take over another firm; this is unduly restrictive. If the taxman is worried about the use of shell companies to siphon off funds, he needs to catch them, not make life difficult for start-ups. Also, there is little point coming up with new rules if the 2,000-2,500 tax orders already passed are not scrapped based on the new rules.

SurveillanceState

The release of surveillance data from China demonstrates the restricted freedom the country's citizens and minorities enjoy

A DISCOVERY BY Victor Gevers, a Dutch cybersecurity researcher who revealed the said data on Twitter last week, has given a rare glimpse into China's extensive surveillance of Xinjiang, a remote region in the west of the country, home to an ethnic minority population that is largely Muslim. The database was a compilation of real-time data on more than 2.5 million people in western China, updated constantly with GPS coordinates of their precise whereabouts. Alongside their names, dates of birth, places of employment, sex, home address, official identification card number, etc., there were notes on the places that they had most recently visited. The database Gevers found appeared to have been recording people's movements, tracked by facial recognition technology.

And now, questions of privacy and freedom abound, but this kind of extensive surveillance is not new for China, which is known to have strict internet surveillance and censorship rules, or the US, for that matter, ever since Edward Snowden, in 2014, leaked details of extensive phone and internet surveillance by American intelligence agencies to the media. In the Chinese case, the *New York Times* reports that the ruling government has established a robust and nation-wide facial recognition and artificially intelligent surveillance system with more than 200 million surveillance cameras, with the aim of tracking the exact movements of citizens. And what these cameras and video feeds are used for in the politically tense atmosphere of Xinjiang, no matter the rest of the country, does not bode well for the minority communities there. The province has been subject to severe security measures by the Chinese government over the past few years in the name of quashing and cleansing the society of extremist movements, like internment camps that the government says are vocational training centres designed to rid the region of latent extremism. Despite a UN committee reporting last year that these centres could be used against those peacefully exercising their rights, thus facilitating the "criminal profiling" of ethnic and religious minorities, and more such international condemnations from human rights groups and national governments, greater concerted international action continues to be absent, placing the lives of the ethnic minorities in further jeopardy.

What choices does India have?

Is India ready for a long war? It is easy to unite while the blood is boiling but a long hard war with no end in sight is another matter. It is unknown in India

MEGHNAD DESAI

A prominent economist and labour peer



INDIA IS UNITED—by Pakistan. That is the paradox of nationalism. Every nation has a favourite or most-hated enemy. For France, it was Germany for over a hundred years. England had France as its enemy for nearly a thousand years. India has, since the 1947 partition, Pakistan as an enemy.

It has fought four wars with Pakistan. It began within months of independence in Kashmir. In 1965, Shastri surprised everyone by asking the Army to cross the border at Punjab and reverse the balance of the conflict which Pakistan thought would be in Kashmir. India was able to assist the Mukti Bahini to dismember Pakistan and help create Bangladesh. In Kargil, despite the surprise, India won. There is little doubt India could win again in a limited war, but the risk now is that both countries have nuclear weapons.

There are people who want peace. They emphasise the syncretic culture between the two nations. There have been people who wish the reunion of the two countries, if not that of all three which were once united. But after Pulwama, this is a distant dream. The urgent task is now to think about retaliation.

Time is short. Though the decision is with the armed forces, the imminence of elections makes it urgent that the war be got out of the way before voting starts. The war has to be of limited duration and one in which India sets itself a precise goal and can unilaterally end the war. Not that anyone is likely to be told what the Army will do. Nor do they need amateur advice.

Even so, what can India do? The most direct and legitimate action

would be to cross the Line of Control and occupy Azad Kashmir. This makes it clear that it is being used to transport terrorists and India wants to shut this gap. Azad Kashmir is of an indeterminate status as it was seized by Pakistan as part of an unsettled war of 1948, but still legally is a part of India as per the Treaty of Accession that the maharaja of Kashmir signed with India.

As some loss of life, the Indian Army could occupy Azad Kashmir. Retaining it would be difficult. It could be made into an international dispute, going possibly to the UN. If so, India could hold it forever given how long it takes UN to solve any such dispute. This would be ending the 1948 war.

This is not likely to end there. Pakistan, along with China, is bound to open another front in the northern border regions of India with China. This is tricky territory and India will face two enemies simultaneously. If the conflict lasted, it could escalate, bringing the US on to India's side. Trump has declared his dislike for Pakistan as a haven of terrorism. He has no time for China either. India has maintained an implicit understanding with the US ever since Manmohan Singh's nuclear decision which George Bush helped with.

Is India ready for a long war? It has no experience of prolonged war. It experienced defeat and humiliation

in 1962 but that is now forgotten. It is easy to unite while the blood is boiling but a long hard war with no end in sight is another matter. It is unknown in India.

It would make more sense to inflict damage by a strictly limited action which would be like a hit and run. As in 1965, it could be away from Kashmir. This would involve action across the Punjab or Rajasthan border. Like the surgical strike, India could hit the enemy camps and then withdraw. Pakistan may retaliate by opening another front and then the war could extend across the border.

Then there is the naval option. India and Pakistan have only fought land wars. Given the recent upgrading of the Indian Navy, it would be possible to deploy the Navy to attack Karachi, a sort of reversal of 26/11. This could be a limited engagement, striking a symbolic blow and demonstrating India's naval superiority.

These are just arm-chair speculations. What the Army will do is quite properly a secret and no amount of outside advice is going to matter. It will, however, alter the dynamics of the election. All the other issues will be off the table during the period when the Army is engaged.

The government cannot take for granted that it will benefit. That will depend on the success of the strike and any repercussions which may follow if Pakistan escalates the quarrel into a full-fledged war.

What the Army will do is quite properly a secret and no amount of outside advice is going to matter. It will, however, alter the dynamics of the election and has to, thus, be of limited duration

LETTERS TO THE EDITOR

Lowering of rates

RBI recently cut the repo rate by 25 bps, but there is no indication yet on the ground to show that credit flow has been broad-based with banks still remaining reluctant to lower their lending rates. With Consumer Price Inflation having touched a nine-month low of 2.05%, banks should be nudged to lower the lending rate before RBI embarks upon further monetary easing measures. Agreed, low inflation, low interest rates, a stable rupee and global crude prices augur well for the ruling BJP government at the Centre as it gears up to face the Lok Sabha polls, but when low or negative food inflation is synonymous with rural distress, and with both the Centre and states running fiscal slippages, it casts a big shadow over their commitment towards macroeconomic stability. Staying course on macroeconomic stability by the elected governments without resorting to populist measures during election season would bring more tangible benefits to our economy. Fiscal prudence should not be sacrificed at the altar of populist schemes — M Jeyaram, Madurai

A shocking tragedy

The tragedy in the skies over Bengaluru that claimed the life of one pilot and left two others injured has left aviation buffs stupefied. The accident occurred after two Hawk aircraft of the Surya Kiran Aerobatics team collided in mid-air with one aircraft cannoning into the other's cockpit during a dress rehearsal for the Aero India 2019. The flying manoeuvres and aerial stunts are no doubt breathtaking but can go awry as this mishap proved — Ravi Chander, Bengaluru

● Write to us at feletters@expressindia.com

THE FINANCE BILL, 2019, has introduced a far-reaching tax reform. Clause 8 of the Bill has enhanced the rebate under Section 87A from ₹2,500 to ₹12,500. As a result, about 40% of individual taxpayers on the records of the department—those with returned total income of ₹5 lakh or less—are absolved of any obligation of paying income tax.

In practical terms, after availing standard deduction as well as other deductions for long-term savings etc, salary earners can easily earn up to ₹60,000 per month without having to worry about income tax. The impact of this reform on the economy is likely to be multi-layered and complex, but mostly beneficial.

The finance minister had, in his Interim Budget speech, estimated the cost of this reform at ₹18,500 crore—the revenue loss emanating from this measure. The government appears to have computed this by aggregating the revenue gathered from slabs below ₹5 lakh. This calculation is fallacious because, historically, whenever tax rates have been reduced, collections have shot up.

Thus, when in FY75, personal income tax rates were reduced from 97.75% to 77%, and then later in FY77 further reduced to 66%, the net revenues of the government of India from this source—after deducting the states' share—spurred from ₹213 crore in FY74 to ₹362 crore in FY75 and further to ₹542 crore in FY77. Sometimes, however, the spurt comes with a lag of a few years. For instance, over FY86 and FY88, the number of tax slabs were reduced to four, and the maximum tax rate was further brought down to 50%. Revenues, correspondingly, increased from ₹697 crore in FY85 to ₹1,492 crore in FY89.

These instances can be multiplied, but the fiscal history of modern India quite clearly establishes that rate cuts tend to increase and not decrease tax revenues. In practical terms, therefore, the recent rate cut may not only have no cost, but may actually result in revenue gains.

What explains this phenomenon?

Arthur Laffer, the noted American economist, points out that starting from a tax rate of nil, every increase in the rate of tax will, in the first instance, lead to an increase in revenue. After an optimum point, however, a further increase in rates will lead to a decrease in total revenue. It follows then after such a point a decrease in rate will lead to an increase in total revenue. Unlike many other countries—especially in developed world—in India the Laffer curve appears to be not an idle theoretical construct, but a reality.

Quite apart from public revenues, the new rationalised structure of rates is likely to affect the economy in a number of other ways as well. Firstly, among the



ILLUSTRATION: ROHINIT PHORE

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● **INCOME TAX**

Towards the 'right' rate structure

The economic impact of the recent rebate in income tax announced in Interim Budget is likely to be multi-layered and complex, but mostly beneficial—historically, whenever tax rates have been reduced, collections have shot up

affected middle classes, it may drive people to work harder, because whatever additional income they earn will now remain with them. Unlike the rich, these taxpayers value additional income much more than additional leisure.

Secondly, many of them may now declare to the tax authorities some income they were earlier trying to evade or avoid. This is because they may now find that the cost of compliance is low, but that of evasion and avoidance is high.

Finally, the additional income now available to the taxpayer will either be saved or spent. At the macro level, if it is saved, it will help enhance household savings (recovering from a five-year low of 16.3% of GDP in FY17) and translate into much-needed investment. On the other hand, if it is spent, it will augment sagging consumer demand, which may help firms utilise excess capacity, and ultimately spur them into making fresh investments in capital goods. In either case, the overall economy will benefit.

The main criticism against this measure is that the ruling government

The new government can consider adopting rate of 10% for incomes up to ₹10 lakh, 20% between ₹10-25 lakh, and 30% above ₹25 lakh, as was suggested by draft DTC 2009

should not have waited till its last Budget to announce the same. The current government was elected on the plank of "minimum government and maximum governance". This tax reform is very much in line with that promise. With the maximum marginal tax rate of 30% (about 36% with various cesses and surcharges), applicable to incomes above ₹10 lakh, India's rate structure is internationally competitive. The 30% band, however, kicks in at a comparatively lower level than in many other countries. In addition, the bands themselves need to be elongated. This is because they were set many years ago. Because of inflation, many taxpayers find themselves being taxed at higher rates, without their real income having increased.

The draft Direct Taxes Code presented for discussion by the UPA government in 2009 suggested a rate of 10% for incomes up to ₹10 lakh, 20% between ₹10 lakh and ₹25 lakh, and 30% above ₹25 lakh. In the Indian context, this is a pre-eminently sensible rate structure that a newly elected government should seriously consider adopting when it presents the full Budget later this year. This would carry through the current reform to its logical conclusion.

Not just straws in the wind

JAMAL MECKLAI

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Change is definitively in the air and there is little doubt that tax rates on the wealthy in the US are going to rise

AN EDITORIAL I READ in the *Financial Times* reported that sales of vinyl (records) have been exploding—25% year-on-year in the US and 17% in the UK—as have sales of hardback books (31% y-o-y). "The millennial generation (those born after 1996) is an important contributor to this phenomenon, seeing the vinyl record (as) an example of the "authenticity" they crave in everything from food to politics."

The current issue of *The Economist* has a cover story titled 'Millennial Socialism'—unsurprisingly, they believe it is not the answer to capitalism's problems.

AOC—Alexandria Ocasio-Cortez, the youngest member of US House of Representatives, and, at 29, a little older than the millennials—has been making waves as a member of the Democratic Socialists of America and advocating a progressive platform that includes Medicare for All, jobs guarantee, guaranteed family leave, establishing a Green New Deal, abolishing US Immigration and Customs Enforcement, free public college and trade school, infrastructure projects for renewable energy, and a 70% marginal tax rate for incomes above \$10 million.

Elizabeth Warren, a senior Senator who is running for President, has called Trump a "symptom of a larger problem (that has resulted in) a rigged system that props up the rich and powerful and kicks dirt on everyone else." She is calling for a high tax on assets in excess of \$50 million, which approach, in my view, is superior to that of AOC, since (a) it undercuts the likely (bullshit) criticism that it would reduce the incentive for highly productive people to work harder, and (b) redistribution of assets rather than income can generate far more value for the economy, since most of these assets—second homes, high value luxuries—are underutilised in terms of generating income.

Clearly, socialism is coming to America even though an extraordinary number of people in the US (and, to be sure, other countries) are extremely touchy about the word. It's almost as if the benefits of successful socialist economies—Germany and most of Northern Europe, for instance—carry some sort of moral disgrace. It may have to slip in under another name—"a kinder, gentler capitalism", perhaps.

Indeed, it is significant that as far back as the late 1980s, President George HW Bush—never anybody's image of a socialist—spoke of the need for a "kinder, gentler America" highlighting the fact that things were not going the right way in America. And, indeed, the fact remains that in the 40 years since, inequality has soared to levels where talk of socialism is no longer limited to sophomore classes and Che Guevara stories.

Change is definitively in the air and there is little doubt that tax rates on the wealthy are going to rise. I would hope—and it seems a reasonable bet—that tax avoidance (ha ha) and tax arbitrage will come into focus. What seems like a thousand years ago, I used to work as a legal proofreader at law firms in New York and first came across the term "tax avoidance"—to anyone with half a brain, it was clear that this was just a legal way to "cheat" on your taxes. People like Warren Buffett have highlighted this time and again.

The scale of loss to the economy is impossible to assess, but I would bet that easily 2-3% of US GDP is tax avoidance away in various tax havens like the Cayman Islands and others. One idea would be for the US government to pay each citizen of each of these havens, say, \$40,000 a year (75-80% of US GDP per capita) in return for closing down these facilities. A Google search showed the population of Caymans at 60,000 (in 2016); so the payout to them would be about \$2.5 billion; if the total for all tax havens came to 50 times that, the cost would be far less than even 1% of US GDP—the gain would doubtless be many, many times that.

There are much brighter minds than mine that could come up with better solutions—the good news is that many of them will now be working for the people and not just the 1%. Movements like Occupy Wall Street will likely come back to life, perhaps as part of the upcoming Presidential campaign.

Asset prices will fall globally, as the US is still the biggest daddy in the game. This will be no bad thing—most cities have become prohibitively expensive to live in. Indeed, there is already a softening at the top end of real estate; and certain "luxury" purchases remind me of the old adage of buyers having more money than brains, reflecting my earlier point that these assets are certainly monumentally inefficient in terms of generating economic value. Even as interest rates fall faster than currently anticipated, equity markets will remain subdued. There will, of course, be enormous pushback—indeed, there already is. Volatility will rise—buy the Vix.

But the reality is that there are far too many straws in the wind for this to be just another evening breeze.

Making India a defence manufacturing hub

BABA KALYANI

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INDIA IS EXPECTED to be a \$10-trillion economy in the next 12-13 years and its defence spend will reflect this expansion, creating huge demand for indigenously built modern weapon systems. The draft Defence Production Policy (DPP) 2018 highlights major categories of systems—fighter aircraft, helicopters, warships, land & combat vehicles, etc. Such critical platforms clubbed with bringing in high-technology in the country offer huge opportunities for both global and Indian OEMs. Policy goals include achieving a turnover of \$26 billion and additional investments of \$10 billion by 2025. In line with its stated objectives, over the last four years, the ministry of defence initiated many policy and procedure reforms.

DPP 2016 has many enabling features to promote the role of Indian industry: ■ Higher preference for Make-in-India categories; ■ Simplified 'Make' procedure with higher level of funding (90% against 80% earlier); and ■ Strategic partnership model to facilitate participation of Indian private industry, through technology collaboration with foreign OEMs, in select segments—fighter aircraft, helicopters, submarines and armoured fighting vehicles.

Besides rationalising items requiring direct industrial licences (DIL), the government enhanced FDI limit in defence (from 26% to 49% through automatic route, and up to 100% on case-by-case basis through government route where access to modern technology may be involved). Revised offset guidelines have been introduced to simplify processes.

Ahead of the Aero India 2019, the Defence Acquisition Council (DAC) has approved significant changes in DPP, in what is called the third phase of reforms. These are focused on making procurement procedures industry-friendly and simplifying certain aspects, to make it smoother and faster, to meet the opera-

tional requirements of the armed forces. The ministry of defence has launched projects for development of two defence industrial corridors (in Tamil Nadu and Uttar Pradesh) dedicated to defence manufacturing. State governments are offering incentives for starting defence & aerospace industries to attract investments and create job opportunities.

Many Indian companies are suppliers to major OEMs directly and through their tier-1 suppliers. Positive policies and Make-in-India have created enthusiasm among Indian industry, which is on the threshold to assume greater responsibility in making the nation self-reliant in defence production. Private industry has added demonstrable capability for manufacturing warships to gun systems, missile systems, small arms, etc.

The resurgence of India's manufacturing is remarkable. Revenues are soaring and the sector is making its presence felt abroad as many Indian firms are becoming transnational. India is developing into a manufacturing hub for global corporations wanting to leverage

the sector's proven capability in product design, reconfiguration and customisation, assured quality, and value addition.

Civil aviation is also soaring. Passenger traffic is likely to touch 350 million in 2020 to make India the third-largest aviation market in the world. India's fleet of 430 civil aircraft will likely double over 5-7 years. The maintenance, repair and overhaul (MRO) sector is projected to increase from \$700 million to \$1.5 billion by 2020. Rapid growth now calls for on modernisation of airports, communications, navigation and surveillance systems for air traffic management, and facilities for MRO to manage pressure on the existing civil aviation infrastructure.

We, at Society of Indian Defence Manufacturers and CII, believe that global aerospace industries would take a note of these positive developments, and Aero India is a platform to explore scope and opportunities for JVs and partnerships, and would provide a fillip to the defence industry in India, promote investments and build partnership to make India a defence manufacturing hub.

INNOVATION

INDIA'S 7% GROWTH RATE, on an average, for the last three decades, is quite an achievement. But the Indian economy needs to grow at double digits for the next three decades, like China did, to eliminate poverty, provide decent jobs to masses and improve overall standard of living. A way to do so is improving productivity of factor endowments, particularly of the large labour force. Improving productivity and competitiveness across the board depends upon 'innovation' where India's lags behind in a big way from not only developed countries but also from its peers like China.

India's rank on the Global Innovation Index is 57 out of 126 countries, compared to China's 17th. If we look at R&D expenditure, India spends only 0.69% of its GDP vis-a-vis 4% and 2.14% by South Korea and China, respectively. Given the size of China's GDP, the R&D expenditure of China is around 12 times that of India. No wonder, China has surpassed giants in innovation, like the US, Germany and France, and has become number one in both the number of patent applications as well as in the number of patents granted.

India aspires to be the next manufacturing hub, but is fast losing out to China in many sectors. A sector where India still enjoys comparative advantage is pharmaceuticals. In fact, India is one of the largest producers of the generic versions of high-

Are we fast losing out to China?

India needs to focus on policies that promote innovation-led growth to stay competitive in the global market

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quality medicines with lower prices mostly due to competitive advantage in cost of production and R&D. India has been the leading producer in some of the sub-sectors like vaccines and antiretroviral drugs used to combat AIDS. However, India's share in bio-pharmaceuticals is far behind countries like South Korea and China. India's share is less than 3% in the world bio-pharma industry and its mission is to reach 5% in bio-pharma by 2022.

China is the second-largest producer of pharma ingredients. Encouraged by supportive government policies like preferential pricing for innovative drugs, China has been the leader in active pharmaceu-

tical ingredient (API) manufacturing and the second-largest investor in R&D. Some of the advantages to the pharma sector in China are low prices due to bulk production, increasing participation of EU and US companies with Chinese corporations, increase in government expenditure on health sector, new pharma regulatory review and application process, etc.

In recent years, China has focused on innovation. Earlier, the Chinese pharma sector was inward-looking and investors were worried because of unfavourable regulatory issues such as delays in drug approvals, IPR violations and lack of transparency. For example, foreign companies



had to initiate clinical trials despite approval from other countries. However, China has responded to these challenges by taking appropriate measures such as a strong regulatory framework towards transparency, introducing the patent linkage system to minimise patent infringement and patent issues, massive increase in staff at the China Food and Drug Administration (CFDA) to reduce applications from five years to six months, opening doors to foreign contract manufacturing organisations, and also proposing to accept overseas clinical trials.

China has also taken steps to encourage innovation in medicines and medical

devices. The initiatives are meant to accelerate a transparent and quick application and approval process, and to protect the patents and investors in innovation industry. China has developed TRIPS-compliant IP laws and regulations, and put in efforts to improve administrative capacity of IP offices. In 2017, CFDA became a member of the International Council for Harmonisation of Technical Requirements for Pharmaceuticals for Human Use (ICH). This allows China to catch up with high-speed drug development in the EU and the US. Overseas companies can now use optimised review process and international multi-centre clinical trials. Increasingly, China is taking measures to repatriate scientists of Chinese origin and also attracting scientists of foreign origin, which helps in technology transfers. Moreover, Chinese still continue with SEZs and R&D parks with fiscal incentives, discounted utilities, R&D funds and access to funds. Given the ageing population, rising health expenditure including big expenditure on R&D, the pharma sector in China is booming.

India lacks a comprehensive policy for innovation in pharma. Strengthening IPRs and regulatory procedure that facilitate partnership in research, technology and innovation are needed. Stronger sector-specific skill development programme, access to finance through more venture capital investment and seed funding, bet-

ter infrastructure and more PPP are necessary for innovation across sectors, including pharma. India can follow some of the steps China has taken, such as training a large number of PhDs and repatriation of trained scientists, establishment of common environment treatment infrastructure, and regulations for assuring quality and safety of products.

Given the importance of the pharma sector in its contribution to the health sector, employment and exports, India introduced Pharma Vision 2020 and framed policies to reduce time for new facilities, etc, but the focus needs to be on policies to maintain and promote the competitive advantage that this sector enjoys.

What India lacks is the culture of innovation. There are thousands of in-house R&D and industrial centres by both public and private sectors, but these are spread out and lack synergy. It's time to encourage partnership and collaboration for efficiency and better outcomes. More spending on R&D along with better linkages between industries, academics and R&D centres is required. Participation of industry with academic and public institutions, starting from curriculum development to joint research, publications, patents, etc, would create a better innovation environment. India needs to focus on policies that promote innovation-led growth to stay competitive in the global market.