Opinion

MONDAY, MARCH 18, 2019

DIPLOMATIC MOMENTUM

Sushma Swaraj, Union minister of external affairs

"Leaders who describe [failure to get Masood Azhar listed as a terrorist] as our diplomatic failure may see for themselves that in 2009, India was alone. In 2019, India has worldwide support"

SHOBHANA SUBRAMANIAN
shobhana.subramanian@expressindia.com

Modinomics's showing won't draw votes

Lacklustre jobs growth, falling agri-growth drive the narrative on NDA-2's performance on the economy front

PRIME MINISTER NARENDRA Modi could well lead his party to another win in the 2019 general elections. But if the BJP is back in power, it won't be because Indians are feeling better off today than they were in May 2014. They are not, really. The multitude of welfare and support schemes notwithstanding, at least two large sections of society—farmers and the youth—must feel less financially secure. Agriculture has slowed considerably to sub-3% under the NDA from 3.1% and 4.3% under UPA-1 and UPA-2, respectively, and bumper harvests have seen output prices crash. It is not just farmers, though; not too many others would say *'achhe din'* are here. This is despite the fact that India's macro-fundamentals today are much stronger, and not shaky as they were back in mid-2013. Moreover, while the over-leverage by banks and companies hasn't been fully overcome, they are undoubtedly in better shape.

But, while the twin balance sheet problem is being resolved, there are not enough jobs going to keep people gainfully employed. It may not be as bad as CMIE makes it out to be; CMIE says there are eight million jobs less today than there were in December, 2016. But it is also unlikely to be as good as the Ghosh & Ghosh claim that 5.2 million jobs were created in 2016-17 and another 6.2 million in 2017-18. That this data has been revised downward several times, on one occasion by 90%, makes it clear that extrapolating from EPFO and ESI subscriptions is simply not a good enough way to estimate employment. Most of the 'new jobs' are probably new subscribers having come into the EPFO fold as the result of increasing formalisation of the economy. Indeed, had so many jobs been created, consumption would not have slowed the way it has; car sales have been virtually flat in 2018-19 while two-wheeler sales have seen a modest increase.

> There has been some traction on resolving the twin balance sheet problem and the GDP is clocking 8% growth. But, the NPA problem still looms and rising GDP has not created jobs

So, the truth probably lies somewhere in between. But that is bad news because there are a million people looking for jobs every month. Not only have large companies reined in hiring, the organised sector today prefers to hire temporary workers. One can't blame them. They want to keep a check on costs, which is becoming difficult given the bargaining power with the unions. Also, rising wage bills make it harder for exporters to compete in the global market. Companies may have been willing to take on permanent workers had the government made it easier for an enterprise to hire and fire, but labour laws remain rigid. Proposals that would have allowed companies with employees up to 300 to shut down without permission and would have disallowed outsiders from becoming office bearers of trade unions in the organised sector haven't become law.

To be sure, one reason there are fewer jobs on offer is because weak corporate balance sheets have limited capital expenditure by the private sector in the last five years. Reliance Industries may have spent close to ₹2.5 lakh crore on the telecom rollout, creating thousands of jobs, but business houses like the Tatas and Birlas have invested through acquisitions where new workers were not needed. In fact, there would have been some shrinkage in the manufacturing workforce thanks to increasing automation. Also, over the past ten years or so, India has attracted less FDI in manufacturing than in services. But even easing the rules for areas such as defence has had little impact. Make-in-India remains grounded. The government is nowhere close to achieving its unrealistic target of a 25% share of GDP for the manufacturing sector—it is now 16.7%. The loss of traction in Indian industry is all too visible with growth plunging from 6.3% in November 2017-October 2018 to an average of 1.5% in the three months to January 2019. The January industrial production of 1.7% is the lowest since July 2017 save for the 0.3% in November 2018. Credit to industry grew at just 4% or lower in the 12 months to November 2018.

It is the IT and e-commerce sectors that continue to throw up high-end opportunities for engineers, computer scientists and marketing professionals. The e-commerce sector has created jobs at the lower end too—there are many more delivery boys driving around these days. But, seen from the perspective of the pool of people waiting to be hired, this is the proverbial drop in the ocean. Had the government not been so stubborn about easing the rules for multi-brand retail and instead adopted the very benign approach towards the space that it has for e-commerce, the job markets may have been buzzing because a lot more FDI would have found its way into India.

Not only would more professionals have been absorbed, a workforce dominated by people not so skilled, too, would have found more work. In fact, thousands of idle construction workers could have made a living for themselves had the government eased the FDI rules for real estate and also sorted out the mess in the sector by forcing defaulting promoters to sell out and auctioning the incomplete projects to solvent builders. The Awas Yojanas will do their bit but it won't be enough.

The headline GDP data simply doesn't square with much of the high frequency data. The economy may be clocking 8% but this could be an impact of benign commodity prices or belt tightening—including limited hiring—which are driving up profitability. So, rising GDP may not always throw up more job opportunities. Creating these will be a challenge for whichever party comes to power.

Imperfect SOLUTION

Electoral bonds may be flaws, but they are still a better than black money funding politics

GIVEN HOW POLITICAL funding has been a route to whitewash illegal money, the government is right when it says that switching to electoral bonds was a quantum leap in ensuring clean political funding. With electoral bonds, the identity of a large donor is captured by the issuing bank. This means illegal wealth can be traced if it is being ploughed into political funding. But, keeping the identity of a donor 'secret' means the electorate will never be able to check for any quid pro quo that a donor-political party indulge in. Electoral bonds do introduce an element of traceability, but are an imperfect solution.

Petitions at the Supreme Court filed by CPM leader Sitaram Yechury and the Association for Democratic Reforms highlight some new concerns. While the donors remained anonymous in the public domain, parties are also not required to disclose the names of donors who have taken the corporate bond route. At the same time, the government has removed the earlier donation cap of 7.5% of average of three-year net profit for corporate donors. This means a firm can donated unlimited money to party without the public ever getting to know. This surely doesn't help the cause of transparency. Besides, the fact is that, while it was argued that the donors will remain anonymous, with most of the bonds issued and encashed at public-sector banks, the ruling party can always access these particulars since it is the promoter of the PSBs. This means the ruling party can always arm-twist a donor to an opposition party into submission. But, returning to the older system is unacceptable since it will mean giving up even the partial check that is there on black money funding politics in the country.

FROM PLATE TO PLOUGH

FURTHER, THE FOOD SUBSIDIES NEED TO BE REVISITED TO TARGET THEM TOWARDS THE BOTTOM 20-25% OF THE POPULATION RATHER THAN PROVIDING 90% OF THE SUBSIDY TO 67% OF THE POPULACE

Remove consumer bias in prices to increase agri-investment

ASHOK GULATI & RITIKA JUNEJA
Gulati is Infosys chair professor for agriculture and Juneja is consultant at ICRIER

JUST AHEAD OF the 2019 general elections dates announcement, the prime minister launched the centrally sponsored 'Pradhan Mantri Kisan Samman Nidhi' (PM-Kisan) scheme of ₹75,000 crore for small and marginal farm families. On February 24, 2019, from Gorakhpur in Uttar Pradesh, he transferred the first installment of ₹2,000 each (out of ₹6,000 per annum) into the bank accounts of 1.01 crore farm families, amounting to ₹2,021 crore. By March 9, 2.6 crore farm families had, in totality, been given ₹5,215 crore. The target is to cover about 12.6 crore beneficiary farm families by the end of March 2019.

Although the amount involved per family is too little, and coming too late, direct income support (DIS) marks a beginning of a new policy direction. It can reach about 86% of farm families compared to loan waivers that can benefit only a maximum of 30% of peasantry and a higher MSP policy which can benefit a maximum of only 10-15% of peasantry. However, at this stage, one does not know whether PM-Kisan is just for one year or is likely to continue for the next few years. If it is just for one year, it is more a bait for votes than a genuine step towards improving incentives for farmers in a more predictable and structured manner.

Similar moves towards DIS for farmers have been made by a number of states, especially Telangana (Rythu Bandhu scheme), Odisha (KALIA scheme), West Bengal (Krishak Bandhu), and Jharkhand (Krishak Aashirwad Yojana). Each one has its pros and cons, and can be improvised in due course. But we welcome all of these, especially if they continue for at least 3 years towards alleviating farm distress.

In any case, it may be worth pointing out that such a policy of DIS is not a substitute, but a complement, to agri-marketing reforms on the one hand and raising investments in agriculture on the other to make Indian agriculture more productive, competitive, inclusive, and sustainable.

One of the key variables that influences the performance of any sector in the medium- to long-term is investments and capital formation in that sector. The attached graphic suggests that gross capital formation (public plus private) in agriculture, forestry and fishing (GCFA) as a percentage of agri-GDP (in current prices) dropped to its lowest level of 6.6% in 1994-95 but gradually increased thereafter, touching a peak of 18.2% in 2011-12, and then started declining and stood at 13.8% in 2016-17. With incremental capital output ratio (ICOR) hovering around 4:1, this level of investment cannot give more than 3-3.5% growth rate in agriculture, and can never double farmers' incomes by 2022-23, an ambitious target set by the prime minister. Another interesting fact that the graphic shows is that, of the total capital formation in agriculture, the share of public investments has gradually declined from 43.2% in 1980-81 to 18.8% in 2016-17 at current prices and, consequently, the share of private sector investments in agriculture has risen.

While share of private investments in agriculture is overwhelming (81%), they need the right incentives to go up further as a percentage of agri-GDP. This is critical if the annual growth rate in agri-GDP is to be put on a sustainable trajectory of 4+% range. The incentive structure in Indian agriculture, however, is perverse. For the triennium ending 2016-17, the Producer Support Estimate (PSE), a measure that captures farmers' incentives from the output price front as well as budgetary allocations for input subsidies or any income support, was negative to the tune of 6.4% of gross farm receipts. In contrast, China and OECD countries had PSEs of 15.5% and 26% respectively, as per OECD estimates released in 2018.

Looking at these figures, it appears that the income support of ₹75,000 crore that the PM has announced under the PM-Kisan scheme is only a small step to improve incentives for farmers. A more sustainable solution will be to carry out large-scale reforms in agri-marketing and trade policies, along the lines of GST with states, and incentivising the private sector to build more efficient and inclusive value chains for agri-commodities from the farm gate to consumer end.

The first step in that direction will be to change the policy mindset, and eliminate the in-built consumer bias in our food and agri-policies. This requires stopping subsidising consumers by suppressing food prices through archaic laws of the 1950s (such as the Essential Commodities Act, 1955). As per OECD, the Consumer Support Estimate (CSE) for India for the period 2000-01 to 2016-17 is about ₹3.13 trillion lakh crore per annum at 2017-18 prices, and about 81% of this comes from farmers who cannot realise best prices for their produce due to restrictive trade and marketing policies. Further, the food subsidies of ₹1,84,220 crore as provisioned in the current budget (plus a minimum of ₹1,20,000 crore of pending FCI bills) need to be revisited to target them towards the bottom 20-25% of the population rather than providing 90% of the subsidy to 67% of the population. This would then provide a level playing field to farmers, propel their incentives, and propel private investments in agriculture, taking a step towards augmenting farmers' incomes on a sustainable basis. The investments need not be restricted to just augmenting agricultural production but also can be towards fixing the sector's marketing infrastructure, logistics, as well as the linking of production by farmers' groups to organised processing and retailing with a view to minimising market risks, saving wastages, and augmenting farmers' price realisation.

Share of public and private capital formation in total capital formation and ratio of gross capital formation in agriculture (GCFA) to agricultural GDP (at current prices)

(%) 100, 90, 80, 70, 60, 50, 40, 30, 20, 10, 0 — (%) 20, 18, 16, 14, 12, 10, 8, 6, 4, 2, 0

Share of private GCFA (LHS)

GCFA as a percentage of AgGDP (RHS)

Share of public GCFA (LHS)

1980-81, 1982-83, 1984-85, 1986-87, 1988-89, 1990-91, 1992-93, 1994-95, 1996-97, 1998-99, 2000-01, 2002-03, 2004-05, 2006-07, 2008-09, 2010-11, 2012-13, 2014-15, 2016-17

Consumer support estimate (CSE) at 2017-18 prices (₹ trillion)

Year	CSE (₹ trillion)
2000-01	0.26
2001-02	0.45
2002-03	0.42
2003-04	0.53
2004-05	0.98
2005-06	0.98
2006-07	1.48
2007-08	2.75
2008-09	3.47
2009-10	2.60
2010-11	4.04
2011-12	5.84
2012-13	6.09
2013-14	8.74
2014-15	6.17
2015-16	3.72
2016-17	4.76

Source: National Accounts Statistics, Central Statistics Office, 2018; Author's calculation based on OECD-ICRIER Report on India's Agricultural Policies, 2018

Why children are right to go on strike

With the United Nations warning that we have only 12 years to fix the crisis, kids aren't inclined to hang around

CHRIS BRYANT
Bloomberg

JOHN LANCHESTER'S NEW novel, *The Wall*, imagines Britain after "The Change". Following a dramatic shift in temperature and sea levels, the UK has barricaded off what remains of the coastline; in Lanchester's dystopia, there aren't any beaches left. Young citizens bore no responsibility for any of this, but they are the ones who must guard the wall and violently repel increasingly desperate migrants, known as "The Others". If they fail, the young are themselves cast out to sea as punishment. Not surprisingly, they are pretty unhappy about their lot.

"None of us can talk to our parents", says Kavanagh, the novel's protagonist. "It is guilt: mass guilt, generational guilt. The olds feel they irretrievably f*cked up the world, then allowed us to be born into it. You know what? It is true. That is exactly what they did. They know it, we know it. Everybody knows it". It is a sentiment shared no doubt by the schoolchildren protesting around the world on Friday to demand far more decisive action on climate change. Inspired by 16-year old Greta Thunberg's weekly vigil outside Sweden's parliament, the movement has expanded to dozens of countries, including the US. Thunberg has been nominated for a Nobel Peace Prize. Can you really blame the kids? The planet has warmed by "only" about 1 degree Celsius (1.8 Fahrenheit) since pre-industrial times and yet the destructive effects of climate change have become frighteningly apparent. The heatwaves, floods, deadly wildfires and violent hurricanes we have experienced lately are mild compared to what our children will contend with. The world is on track to heat up by more than 3 degrees by 2100 and the warming won't miraculously stop then. "The climate system that raised us, and raised everything we now know as human culture and civilisation, is now, like a parent, dead", writes David Wallace-Wells in *The Uninhabitable Earth*. Unfortunately, this isn't another Lanchester-like work of speculative fiction. It is non-fiction.

Wallace-Wells's book documents the horrors and chaos that those cutting class on Friday want to avoid: Tens of millions of climate refugees, trillions of dollars of economic damage, deadly heat, fresh-water scarcity (the glaciers of the Himalayas will lose at least 40% of their ice by 2100, he notes) and "much more fire, much more often, burning much more land". A single California wildfire can undo all the emissions gains made that year via the state's environmental policies, just one of several terrifying climate feedback loops he describes. Wallace-Wells's writing is of course more vivid than the conservative, consensus-driven reports produced by the UN's Intergovernmental Panel on Climate Change. A journalist, not a scientist, he makes no attempt to hide his alarm nor pull his punches about who to blame. Why should he? More than half of fossil fuel-related emissions have occurred in the past 30 years, during which humans have known this will make the earth far less hospitable. Thanks to Asian demand, we consume 80% more coal today than in 2000. Destroying the environmental conditions that gave rise to the human species "has been the work of a single generation", Wallace-Wells writes.

We adults are proud of the progress we've made in other areas—life expectancy, equal rights, education and poverty, to name a few. But when later historians write about this period, that isn't what they'll remember. Despite the rapid adoption of wind and solar power, big improvements in energy efficiency and electric vehicles, our carbon emissions are still rising. We're locking in more destruction for our kids to cope with. Linking the Fridays For Future movement and young people's enthusiasm for policies like the Green New Deal is the belief that the time for incrementalism is over. Yet, governments and corporate bosses continue to drag their heels. Even those, like Germany's Angela Merkel, who support the kids' right to protest, are guilty. Supposedly a climate leader, Germany is recklessly phasing out nuclear power but plans to continue burning coal for another two decades. Car manufacturers like Fiat Chrysler Automobiles NV tout their electric plans while gorging on US truck and SUV sales. In mining, Glencore Plc is committed to capping coal production at current levels to appease climate-concerned investors, yet it expects fat profits from coal this year, and probably will for years to come. Airlines talk about carbon offsets but they're banking on so much growth that their emissions might rise seven-fold by 2050.

Telling teenagers to be patient or realistic, as US Senator Dianne Feinstein tried to do, won't wash. With the United Nations warning that we have only 12 years to fix the crisis, kids aren't inclined to hang around. It is even more reprehensible that some adults are trying to stymie even our insufficient climate change efforts, by maligning experts and retreating from international cooperation. President Donald Trump, who wants to withdraw from the Paris climate accord, happily expresses his skepticism about the science, but often demonstrates his total ignorance of the subject in the process.

His rise showed the oncoming cataclysm still wasn't a big enough priority for many Americans of voting age in 2016. If he is re-elected in 2020, the die casting today's adults as climate villains will have been cast. Three cheers for the kids, then.

This column does not necessarily reflect the opinion of the editorial board or Bloomberg LP and its owners.

LETTERS TO THE EDITOR

Need for action

Although the Chinese verdict on the listing of Masood Azhar prohibits a conclusive action, an absolute, though not total, majority strengthens the sovereign's stand on international forums and renders the much-needed empathy to the regime's view. While it is important to establish a balance-of-power in the UNSC to attain a democratic representation, a greater focus must be levied on resolving issues and building a robust consensus, especially when it comes to overcoming a chronic global problem. Discussion forums and multilateral groups have achieved very little success hitherto as recurring cease-fire violations reflect upon a greater need to act stringently. With maintenance of international peace and security being a prime responsibility of the council, prioritisation of a befitting action against a hostile entity is the need of the hour

— Girish Lalwani, Delhi

Well-deserved success

Team Karnataka deserves encomiums on coming out with flying colours in the Syed Mushtaq Ali Trophy tournament and going on to bag their maiden T20 title. After their bowlers did well to restrict rivals Maharashtra to 155, Manish Pandey and company got home with an over and a half to spare. Opener Mayank Agarwal continued his impeccable showing with the willow, blasting an unbeaten 85 and young Rohan Kadam also showed great flair in making a wonderful 60. The well-deserved success must come as a shot in the arm for Karnataka cricket

— Ravi Chander, Bengaluru

●Write to us at feletters@expressindia.com

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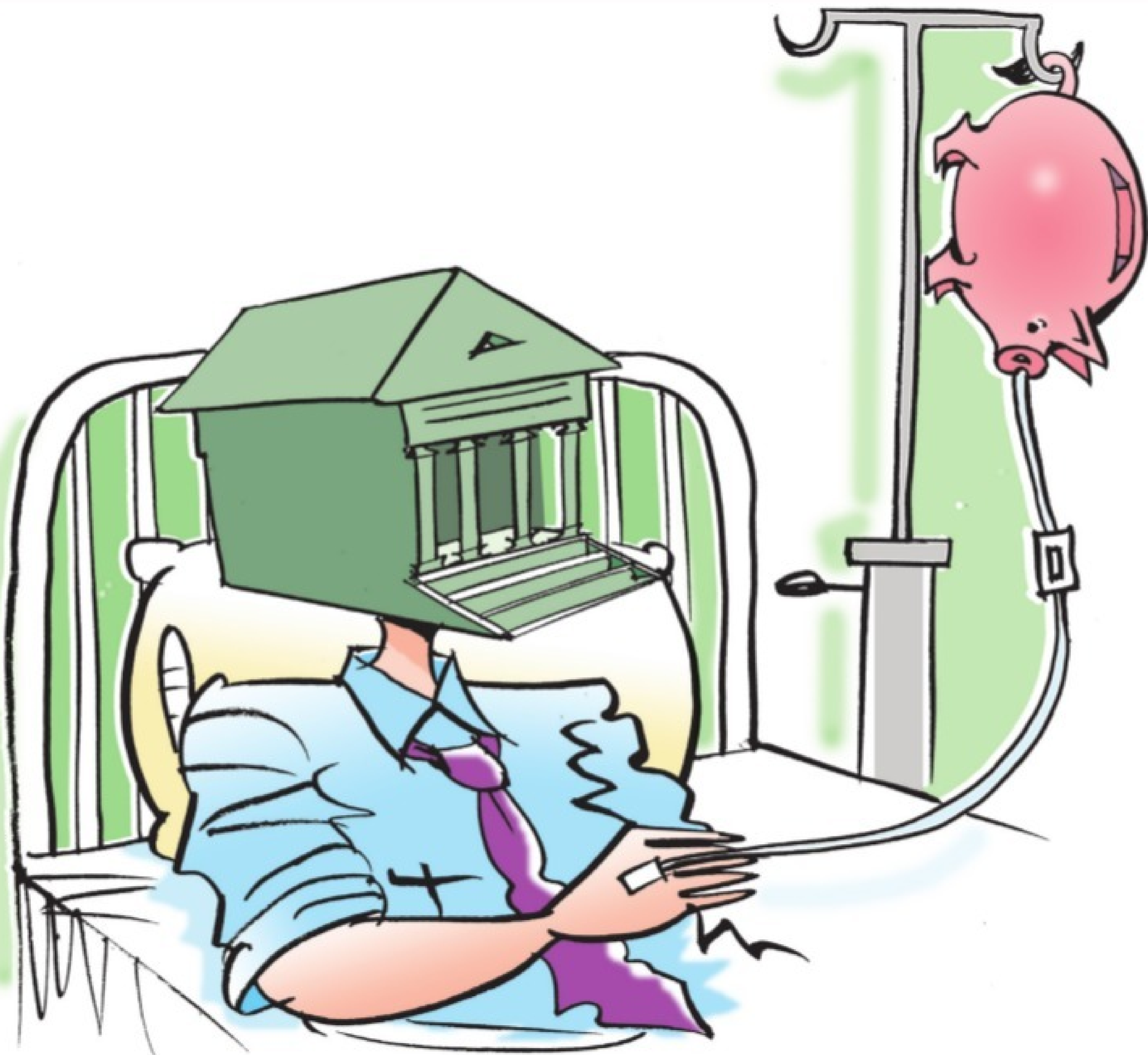

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SOUMYA KANTI GHOSH

Group Chief Economic Advisor, State Bank of India
Views are personal

Using call rates as a proxy for systemic liquidity

Issues relating to market microstructure needs to be addressed to have a holistic assessment of the WACR being used as a proxy for liquidity management tool

RBI NEEDS TO BE COMMENDED for several ingenious and bold steps that it has taken recently to address market microstructure and improve communications with market by engaging in constant interactions. Recently, RBI expressed its intent to inject liquidity through swap transactions. While this move has been welcomed by the markets, it has also raised an important question: How far the existing liquidity management framework is an adequate reflection of liquidity?

We estimate that all scheduled commercial banks currently have only 2.55% of excess SLR (0.55%, if we net out the G-Secs for daily transaction and cash needs) that they can use as a collateral to borrow from RBI or that can be used by RBI for OMO purchases. Hence, the question 'why did RBI have to take the swap route for injecting durable liquidity?' arises

The issue of not having adequate collateral brings us directly to the current working of RBI's liquidity management framework as it is exactly based on this premise. Specific banks (mostly having a strong retail franchise) can borrow from RBI only against their collateral (that is less than 2% of bank liabilities), and there are instances where banks (wholesale) cannot borrow and must specifically mobilise public deposits to meet their funding requirement. Thus, it is no wonder that incremental credit deposit ratio is running more than 100% now, with CD and repo rate spread at more than 150 basis points. Thus, the existing liquidity framework may not be a complete indicator of liquidity tightness in the system. The logical corollary of this argument is then "Why call rates are not showing up in this liquidity tightness?"

Before we explain such an anomaly, to be fair to RBI, in the February 2019 issue of the RBI bulletin (Contours of Liquidity Management: Developments During 2018-19), there is a succinct summarisation of the liquidity operations by RBI during FY19. The article articulates how RBI managed the liquidity in the situation where fears of global trade tensions intensified and faster-than-anticipated normalisation of the US monetary policy led to capital outflows that exerted depreciation-pressure on rupee. We believe the market may be well advised to take cognizance of such communications from RBI to understand the nuances of liquidity management.

We believe the lacunae in current liquidity management by RBI is that, presently, frictional liquidity injection (repo transactions to compensate for government cash balances) is substituting for durable liquidity (injections through OMO to compensate for currency leakage and liquidity impact of RBI forex intervention), and, hence, this is resulting in an imbalance between effective mix of durable and transient liquidity injection resulting in market imperfections.

Experience suggests that the provision of short term/frictional liquidity does not substitute fully for durable liquidity, though durable liquidity can substitute for short term/frictional liquidity needs (RBI monetary policy statement: April 2016). For example, when the currency leakage was combined with the liquidity outflows/forex sales which took place this year, amid the FII outflows, then RBI was able to just compensate 51% through the durable liquidity method till January 2019. On the other hand, till December 2018, the total amount of repo injections has more than fully compensated the variation in government cash balances.

Now, coming to the weighted average call rate (WACR), over the years, the share of call money has declined significantly (currently around 10% compared to 60% share of TREP market and remaining 30% of market Repo). Additionally, the movements in WACR could be liquidity-agnostic as it has hardly moved even when deficit has been as large as ₹2.6 trillion. The WACR is highly skewed. In the morning (the first hour of trading in the inter-bank call money market usually accounts for about 75-80% of the day's volume), the call rate is high, and in the evening, it is low as some banks dump their excess liquidity in the call market after netting their positions in other markets. This is a regular feature and distorts the WACR. Also, most of the co-operative banks are not participants in the NDS-Call trading platform. The absence of uniform market hours across all money market segments which are not in sync with RTGS timings often have a destabilising impact on the WACR.

Clearly, issues relating to market microstructure needs to be addressed to have a holistic assessment of the WACR being used as a proxy for liquidity management tool.

So, what next? We believe RBI could also use, as risk spreads, incremental credit deposit ratio to have a comprehensive assessment of systemic liquidity and not only call rate. First, we suggest that banks may be allowed to use the full mandatory SLR for maintaining or allowing CRR in the computation of HQLA. This will release around ₹5 lakh crore worth of G-secs into the system that could be used for on-lending. Second, the unspent cash balance of the government is now being auctioned by RBI through repos. Such cash balances of government can become a part of permanent liquidity if transferred to banking system and can be put to productive use. It will also provide a clear picture of the money available within the system, which will not get distorted by government borrowing. Third, can we think of a futures market for the uncollateralised call rate trading that would give an indication of future market expectation on rates as in the US?

Before we end, one suggestion for markets. In recent times, RBI communication has shifted from speeches to more rigorous research articles that underlines subtle policy changes. The market could take a cue from such publications and, thereby, tactically be in sync with RBI policy shifts. This could in effect reduce volatility in financial markets.

● SIGNIFICANT ECONOMIC PRESENCE

Some unanswered questions

VINTI AGARWAL AND VIDUSHI GUPTA

Research Fellows (Tax Law Vertical), Vidhi Centre for Legal Policy
Views are personal

Many aspects of the amendment need to be clarified, including who is a "user"

IN THE LAST FEW DECADES, business operations have seen a paradigm shift because of digitalisation. This has led to the development of new business models that depart from the traditional practices, and rely largely on technology. The unique features of businesses in this landscape pose significant challenges in taxing their income. While income tax laws impose levies based on the place of residence of taxpayers and/or their source of income, such laws were conceptualised with brick-and-mortar businesses in mind. Given that, in the digital economy, these conventional concepts are blurred, businesses have opportunities to circumvent tax laws, and set operations to minimise tax liability.

Since most cross-border transactions are governed by Double Taxation Avoidance Agreements (DTAAs) that override domestic laws, there isn't much that countries can unilaterally do to bring these digital businesses under their tax net. There is global consensus regarding the need for a comprehensive mechanism to tax cross-border transactions in the digital economy and OECD, the UN and the EU are working on a resolution. The Centre amended the Income Tax Act in 2018, and introduced the concept of 'Significant economic presence' ('SEP') which is effective from April 1, 2019.

The Indian income tax framework currently taxes income that accrues or arises through a business connection in India. The amendment widens the scope of 'business connection' and includes SEP within its ambit. SEP has been defined as:

■ Transactions in respect of goods, services or property carried out by non-resident in India including the provision of download of data or software in India, if aggregate payments from such transactions during previous year exceeds such amount as may be prescribed; or

■ Systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed.

An amendment to the domestic law of a country will not have an impact on DTAAs as the latter override the former. However, if the amendment in question is, indeed, made applicable from April 1, 2019, its application will be limited to countries with which India does not have DTAAs viz. the Bahamas and Hong Kong.

India attempting to tackle the problem of taxing the digital economy is a welcome step, but the implementation of the SEP provision, in its current form, will create more problems.

A primary concern is the absence of rules, or other supplementary guidance to help interpret the provisions and define its scope. It is relevant to note that income tax can be levied in India on the transactions mentioned in the first part of the definition only if the non-resident provider generates a certain revenue. However, there is no such corresponding revenue requirement under the second part.

Despite its deviation from the OECD's suggestion, the sheer scope of the definition may not have been such a concern, had it been supplemented with guidance on the interpretation of crucial phrases such as 'systematic, continuous soliciting', and 'users'. While the introduction of an exhaustive definition, or a straitjacket formula could be difficult, given the dynamic nature of businesses in the digital economy, at least an illustrative list of activities that the government seeks to include within this definition is imperative. Without any indication as to the intention with which these amendments are introduced, they would not satisfy the intended purpose and would lead to potential taxpayer harassment and litigation. 'User' is a crucial concept, and its interpretation would result in the inclusion of fresh businesses in the tax net. However, there are no guidelines regarding the level of engagement at which one would qualify as a user. For instance, would merely visiting the website once qualify one as a user, or would one have to click on certain links to fall within its ambit? It is relevant to note that the government had invited comments as well as suggestions from stakeholders on the revenue threshold and the user threshold. However, comments on the scope and interpretation of the provision were not sought.

Lastly, the provision states that only that income that is attributable to the transactions or activities constituting significant economic presence will be said to be deemed to accrue or arise in India. However, no mechanism has been devised for attribution of profit. Before the provision becomes effective, rules must be framed for its effective enforcement.

In order to facilitate compliance, and enable a smooth transition for businesses, the SEP provision should be made effective only after investing sufficient thought into its nuances.

CRUISE TOURISM

Get taxation right for Indian players

The govt must give Indian players a favourable tax regime; else, they will lose out to foreign operators

PANKAJ BAGRI & NAMAN SHAH

Bagri is partner, and Shah is manager, Deloitte Haskins & Sells LLP *Views are personal*

CRUISE TOURISM IS regarded as an integral part of the tourism industry of major coastal countries globally. With a coastline of more than 4,600 miles along with great heritage and culture, a diverse terrain and, a variety of flora and fauna, India has a great potential for the cruise-tourism sector. However, cruise tourism in India is still less explored and mostly untapped due to various factors such as regulatory approvals, taxation, etc.

In the recent past, leading cruise liners have been targeting India as a prospective market and the Union government has been encouraging these cruise liners to increase their operations in India. However, due to a unfavourable regulatory and tax environment in the past, the growth of cruise industry hasn't matched its potential so far.

Recognising cruise toursim's potential (in terms of employment generation, economic revenue, etc) and to address the issues faced by cruise liners, the government of India has taken various steps in recent times to promote cruise tourism in India. The Indian government also appointed global consultants to set a roadmap for the development of cruise tourism in India, focusing primarily on the international best practices in relation to infrastructure development along with changes required in policy, regulatory environment and tax laws.

The ministry of shipping, in conjunction with other stakeholders, has taken various steps like development of cruise terminals, relaxation of port charges, relaxation of ship licensing requirements, etc. However, in addition, necessary tax reforms must be announced to ensure a level playing field for cruise operators from India compared to foreign operators. In this regard, it is relevant to note that in major port countries, cruise companies enjoy a tax holiday or their income is subject to a favourable tax regime. These tax benefits offered, in turn, have played an important role in the growth of cruise sector in those countries.

In India, foreign-based cruise liners, plying in India, are either not subject to tax in India in light of the Article 8 of the Double Taxation Avoidance Agreement or are subject to presumptive taxation under section 44B of the Income-tax Act, 1961 ('the Act') with an effective tax rate of around 3.3% on India-sourced income. Further, in many cases, the taxes paid in India are also available as a credit in their resident countries.

On the contrary, Indian companies operating cruise vessels in India are not eligible for favourable tax treatment under Section 44B of the Act. As regards the Indian tonnage tax provisions are concerned, a clarity is required that a cruise ship would be covered under the definition of 'qualifying ship', and not as a 'pleasure craft'. An ambiguity in the definition of qualifying ships under the Indian Tonnage Tax Scheme could lead to tax litigation and, consequently, negatively impact the ease of doing business in India.

Further, it is relevant to note that apart from revenue from sale of tickets and on-board sale of goods and services, cruise companies earn revenue from a variety of activities like casino and gaming, shore excursions, entertainment shows, telecommunication services including internet facilities, gift shop items sales, photography services, spa/salon and fitness services, art auctions, renting of space for meetings/shops, etc. However, under the existing Indian tonnage tax provisions, there is no clarification whether these specific activities carried out by the cruise companies are covered under the 'core activities' of a tonnage tax company. Considering the fact that the aforesaid activities are integral part of the cruise tourism, it is important to clarify that income from such services forms part of core activities.

If a favourable tax regime (presumptive taxation or tonnage tax scheme) is not provided to Indian cruise operators, they will be liable to pay taxes at the normal corporate tax rate of 30% (plus surcharge andcess), which would make them unviable.

Another important aspect under the Indian tax regime is the applicability of Goods and Service Tax (GST) law to the cruise liners. Currently, leading global cruise liners are seeking exemptions from GST stating that cruise companies will face difficulty to operate in a country where they have to pay GST on the ticket price and on-board supplies and services, which form a major part of the total income of the cruise company. This shall have a negative impact on the cruise industry in India. Even imposition of GST on fuel oil used for cruise services substantially increases the cost of cruise companies since it is one of their major cost component.

Further, GST is a destination-based consumption tax, and it is relevant to note that goods procured by cruise companies at various ports are not consumed in the state where they are procured. Various types of goods such as fuel, furnace oil, spares, ship stores, etc, are delivered at various ports and at locations where the cruise companies may not have any place of business or office. Accordingly, input tax credit on such goods may be denied, resulting in significant blockage of input tax credit in various states.

Accordingly, considering the potential of Indian cruise industry and to achieve the growth targets set by the government, it is necessary to adequately address the issues listed here and bring in the necessary tax reforms. These reforms would not only boost the Indian cruise industry but also have positive impact on various allied businesses, inflow of foreign exchange, etc.