

## Electrifying vision, sobering reality

2-wheeler firms being asked to junk current plans for a hazy EV future; if that fails to materialise, will govt compensate them?

GIVEN INDIA'S AMBITIOUS emission-reduction targets at the Paris climate meet, it is not surprising that the government should have an equally ambitious electric vehicle (EV) strategy. According to the plan, all fresh production of three-wheelers are to be based on electric engines by 2023, and the changeover date will be 2025 in the case of all two-wheelers below 150cc. There was also talk of a certain share of the fleet of taxi operators like Uber/Ola being electric by a certain date, but that seems to have been put on the backburner for now. Given India's leadership position in the traditional two-wheeler industry—India exports 3 million two-wheelers a year—and how the advantage will now probably shift to countries like China, it is not surprising that the proposal mooted by NITI Aayog has come in for a lot of flak from manufacturers like Bajaj Auto and TVS Motor Company. But, more than that, what is worrying is the near absence of any concrete plan to make the shift, and to even think through the rationale. If the electric power on which these two-wheelers are to run is based on coal instead of gas or solar/wind, all that the move achieves is emission-shifting, not reduction; that is, the emission will not take place in big metros but in the areas where power plants are located. At the outset, then, the government needed to put out information on the emissions that will be saved, if at all.

There is, as yet, no concrete plan to produce enough batteries or to reduce their costs. Bajaj Auto managing director Rajiv Bajaj told *The Hindu Business Line* (HBL) that there wasn't one battery manufacturer present at the NITI meeting on this last week; China accounts for around 60% of global battery manufacturing right now. India, in contrast, has very small battery assembly facility and no manufacturing capacity. So, if the plan to go EV is just a few years away, for it to have any credibility, by now leading manufacturers should have started constructing their factories in India. And, as compared to China's 3-4 lakh public charging stations, India has a mere 150 and has a target of 5,000 in a few years. Since batteries are very expensive right now, and comprise around half the price of an EV, the government should have gone public with how much subsidy will be given each year to make the 2-wheelers affordable. While nothing of the sort has been done, the government is asking two- and three-wheeler manufacturers to prepare for an EV future in just a few years. Given how the current internal combustion engines are so different from EVs, this means manufacturers will have to virtually start over from scratch, redesign their production, come up with new vendors, etc. But what happens if, as they abandon their current production lines, the government is not able to switch from coal-based to clean power, or to get enough battery manufacturers or charging stations, or to fund a big subsidy programme? Will the government compensate manufacturers for the loss in business? Indeed, this talk of a sharply advanced EV schedule will also play havoc with manufacturers' plans to switch from the existing BS-IV emission norms to BS-VI, since it is possible a large number of buyers will prefer to wait to buy EVs instead. If the government is serious about moving to EVs, it needs to demonstrate this by laying out a concrete plan to get battery manufacturing in India and to detail how it plans to subsidise this. Else, it is just asking Indian manufacturers to trade their leadership position for an uncertain future.

## RBI's problems go Viral!

Sadly, DG's exits strengthens view that govt uneasy with dissent

VARIOUS INDIAN GOVERNMENTS have had, from time to time, top economists who have been educated abroad—indeed, many of Dr Manmohan Singh's team when he was finance minister were educated abroad—but thanks to an unseemly controversy over the past few years, the Narendra Modi government gave the impression that *videshi-bhagao* was high on its agenda. So, before RBI Governor Raghuram Rajan decided not to seek an extension, there was talk of how he was "mentally not fully Indian" and, later, when Arvind Panagariya left NITI Aayog, there was talk of how, under Modi, the foreign influence on policy-making was reducing. If it wasn't bad enough that this made the government look xenophobic, the government constantly, and publicly, attacked Urjit Patel when he was RBI Governor, appointed a well-known critic to the central bank's board, tried to ensure a part of RBI's reserves were handed over to it and even tried to alter the governance structure of RBI to reduce the Governor's powers; indeed, the tussle over RBI's reserves is still carrying on and, if news reports are to be believed, the finance secretary is going to write a dissent note in the Bimal Jalan committee's report on this.

It is true that most expected Deputy Governor Viral Acharya to quit when Patel did, since it was he that delivered the speech talking of how, in Argentina, the bond market taught the government a lesson when it fired the central bank's chief and then transferred a third of its 'excess reserves' to itself; to many, it appeared he was asking Indian bond markets to do something similar since the government here too was looking to sequester a part of RBI's reserves. But when Acharya stayed on after Patel resigned, it appeared as if the new Governor Shaktikanta Das had managed to convince him that the government bore no ill will towards him; the fact that Acharya has now tendered his resignation before his term came to an end, however, suggests the peace was just temporary. As it happened, over the past few months, Acharya has been more hawkish about inflation than others on the monetary policy committee including the Governor. This is not to say that Acharya's view is right—indeed, *FE* has been critical of RBI for not lowering repo rates aggressively in the face of a benign inflation outlook—but his quitting strengthens the view, rightly or wrongly, of the government being uncomfortable with dissent. This is unfortunate and should be a lesson to the government in how to handle criticism; certainly its officials and those associated with it should refrain from berating those with a different point of view.

## SouthsideSTORY

Residents of the southern states spend more on tertiary education and choose STEM degrees over general ones

THE SOUTHERN STATES outperform most of their counterparts elsewhere in the country in terms of human development. Recent research, however, has found that regional differences exist not only in educational outcomes but also in educational choices and household expenditure on education. Using data from two sets of NSSO surveys, researchers from the Indira Gandhi Institute of Development Research, Mumbai, found that individuals residing in the southern states are more likely to pursue higher education, especially in technical streams like medicine and engineering, than those residing in northern states. Even among rural populations, who are less likely to pursue tertiary education than urban residents, those who do pursue it tend to opt for technical courses over general education, and science and commerce over humanities within general education. The study also found that students from South Indian states are more likely than their North Indian counterparts to enroll in private, unaided institutions, thereby adding significantly to their educational expenses, especially through educational loans—southern states were found to account for over 70% of all education loans in India.

A large part of this regional variation is explained by the differences in levels of economic development between northern and southern states—along with finding a positive association between this spatial pattern in education and urbanisation levels, researchers argued that poorer households, being risk-averse, are unlikely to invest in the longer-term gains from higher education over immediate benefits. Yet, differences between the infrastructural and policy environment surrounding higher education—quality of educational institutes and instructors, seat capacity, prospects of future employability, ease of obtaining loans, etc—too, are a contributing factor. If the North wishes to catch up with the South, it is in these regards that it must take a leaf out of the latter's book.

### INDIA'S TELECOM JOURNEY

SPECTACULAR CHANGES IN INDIAN TELECOM SINCE THE 1990s OFFER VITAL INSIGHTS FOR SHAPING THE FUTURE OF EMERGING SECTORS OF THE ECONOMY

# The missed-call capital becomes the selfie capital

RAJAT KATHURIA

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*Views are personal*



lation made popular by Anglo-Saxons for the telecom sector at that point in time. Thus, SOP was eventually achieved by creating TRAI separate from service providers, by limiting DoT to policymaking and by creating an appellate tribunal (TDSAT) that resembled a judicial body in form and character. The 'unbundling' of the erstwhile public-sector monopoly was complete—SOP, with an irrefutably Indian personality was achieved, in theory if not in practice.

Prior to TRAI's entry, mobile telephony was the preserve of private players and peak mobile tariffs were extraordinarily high—₹16.80 for both incoming and outgoing calls. DoT had perhaps intended to price the private entrants out of the nascent market but underestimated Indian ingenuity. The excessive price inspired the Indian consumer to be thrifty. Thus, 'missed calling' became a necessity with pre-set interpretations of number of rings and timing of calls. While India now has one of the lowest tariffs in the world, it is still the 'missed-call' capital of the world.

Structural reform of the sector has no doubt borne much desired dividends, alongside offering rare insights into our political economy. Meanwhile, and relatively unobtrusively, the foreign direct investment (FDI) regime for the sector has been liberalised to keep pace with structural reform. The caps on the maximum foreign equity participation in telecom companies incorporated in India have been gradually eased. In November 2005, the Government, through Press Note 5 of 2005, raised the FDI limit applicable to the sector from 49% to 74%, subject to compliance with certain conditions, including that the majority of the directors, and selective key senior management personnel be resident Indian citizens and that a resident Indian pro-

moter hold at least 10% equity of the company. In August 2013, 100% FDI in the telecom sector was permitted for all services. Cumulative FDI inflows to India in the sector until June 2018 were over \$31 billion.

As Indian telecom liberalised, it became a darling with foreign telcos wishing to offset slowing growth in their home markets. Over the years, many came and exited while others came and stayed and, if you will, conquered the market. SingTel and Vodafone invested in India directly or through local operators. On the other hand, AT&T, which previously owned one-third equity in a telecom joint venture, exited along with Telenor, Swisscom, Belgacom and Japan's NTT DoCoMo. Recently, Vodafone India merged with Idea Cellular while Bharti Airtel continues to be backed by SingTel. Reliance Jio's success lies, in large part, in alliances—such as those with BT Group Plc and Deutsche Telekom AG among several others. Equipment makers Huawei, ZTE, Alcatel, Nokia and Ericsson have been the source of advanced technology while IBM has been a solutions provider to many telcos. Thus, it would not be an exaggeration to assert that behind every successful Indian telco there is a foreign hand! As a corollary, one could assert that Indian computer scientists and coders have played key roles in many telco successes abroad.

Structural reform expressed in the SOP principle and liberalisation, manifested in easing FDI norms, jointly transformed telecoms in India. Besides a billion-plus mobile subscribers, there are over 600 million internet users, of

which 493 million use the internet regularly. Smartphone ownership is a staggering 450 million and rapidly growing. On social media, India surpassed United States in active Facebook usage (260 million vs 190 million). Instagram, a rising social media platform, has an Indian user base of 72 million. The rising tide of Instagram Influencers in India helps brands grow awareness and, increasingly, drive sales. LinkedIn, with 56 million Indian users, has facilitated job market search and matching. From being the missed call capital, India is well and truly 'posing' to become the selfie capital, embracing, regrettably, its dark side as well. But, let's keep that story for another day.

**A collaborative strategy that combines respective comparative advantages of various actors across space (and time) works better than an 'India first strategy'**

The change in Indian telecom, especially for those who lived through the 1980s and 1990s, has been spectacular and offers vital insights, which can be usefully transported to present-day India even as the new government attempts to shape the future of emerging sectors of the economy. The primary lesson is this—a collaborative strategy that combines respective comparative advantages of various actors across space (and time) works better than an 'India-first strategy'. To use a hackneyed turn of phrase, India *will* become first if it adopts a collaborative rather than a protective approach. Let's we be deliberately misunderstood or misinterpreted, collaboration does not mean throwing India under the bus or selling out to foreign interests; rather, it implies recognising our negotiating strengths and doing what's best for collective welfare. Cambodia, Vietnam and Indonesia, among other countries, are waiting and watching for us to move the wrong piece. But, if we make the right move, as the poet Majrooh Sultanpuri reminds us, we will be joined by others to create the extensive agglomeration effects mentioned in this article. '*Main akela hi chala tha janib-e-manzil magar, Log saath aate gaye aur karwaan banta gaya*'.

Ankita Sharma, research intern, ICRIR, assisted with the article

### LETTERS TO THE EDITOR

#### Kashmir imbroglio

The call for dialogue from Mirwaiz Umar Farooq, a moderate leader in the Kashmir separatist group of Hurriyat Conference, is welcome. Absence of sustained dialogue and engagement with the stakeholders of Kashmir imbroglio, including the separatist elements, and the policy of quelling protests on the streets through force by Modi 1.0 had done more harm than good to the larger cause of peace in Jammu and Kashmir. Rise in militancy in the last five years is a case in point. The political vacuum that presently exists in the state, manifests itself in the absence of elected government; this prolonged absence of engagement with the political class of the state cannot be allowed to persist for long. It is time the Centre shed its intransigent attitude and ushered in measures to arrest the deepening sense of alienation among Kashmiris, particularly its youth, to prevent militancy from gaining upper hand in the state. — M Jeyaram, Sholavandan

#### Removal of HC Judge

The present procedure of removal of HC judges through impeachment by Parliament is cumbersome, especially in the case of Justice SN Shukla of Allahabad HC, who was indicted by an in-house panel and has declined to resign or take voluntary retirement. GOI must constitute a permanent National Judicial Commission as the final authority in appointments and probes against HC

— Subhash C Agarwal, Delhi

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## Business must fight climate change

Businesses and investors thinking of what assets to build and finance, and where, are signaling that they are aligning themselves with ambitious climate goals

NATHANIEL BULLARD

Bloomberg

LAST WEEK, THE New York State Assembly passed the most aggressive clean-energy target in the United States, requiring New York to get 100% of its electricity from zero-emissions sources by 2040. Governor Andrew Cuomo, who is expected to sign the bill into law, called it "the most aggressive in the country." On the other side of the country, Oregon's state Legislature is attempting to pass another ambitious climate bill, an effort now stalled by the fact that Republican senators have walked off the job. In the absence of federal action on decarbonising the power sector, states are taking action on their own.

These state goals are ambitious, and they're potentially unachievable using current technologies. But they are becoming policy reality, not political rhetoric. Businesses and investors thinking of what assets to build and finance, and where, are signaling that they are aligning themselves with these ambitious climate goals. The Network for Greening the Financial System, a group of central banks and supervisors that assesses climate risk and mobilises climate finance, doesn't see climate change as abstract. Rather, it is of a "foreseeable nature," and "while the exact outcomes, time horizon and future pathway are uncertain, there is a high degree of certainty that some combination of physical and transition risks" will eventually materialise.

If those risks are foreseeable, then they can be priced. And if those risks manifest themselves financially, then they should be disclosed as well. In its most recent status report, the Task Force on Climate-Related Financial

Disclosures said that it now has almost 800 supporters, up from just over 100 only two years ago. The group's disclosure framework has been appearing as corporate commitments to reduce exposure to climate change or curtail business activities that cause it. Crédit Agricole recently published its 2022 Medium-Term Plan, which not only aligns itself with the TCFD, but also goes directly after its own book of business in thermal coal used for power generation. The bank says it will be exiting from thermal coal production in EU and OECD countries by 2030 (no new business relations with companies for which thermal coal accounts for over 25% of their revenues except those that have announced plans to close their thermal coal activities or which intend to announce such plans by 2021).

In a separate news release, the bank said it would also double its green loan portfolio to 13 billion euros by 2022. Its planned increase tracks an expanding market that could top 2018's record of \$182 billion of green bond issuance. Credit Agricole and its peers are typical green bond issuers, and as Brian Chappatta of *Bloomberg Opinion* noted, the green bond field is not only growing, but it is also becoming more diverse. That's a welcome change from last year, when Chappatta said the market "appeared to be stuck in infancy because of self-designating and a general lack of enforcement".

It's not entirely clear what changed. Maybe countries and companies truly

are reacting to the U.N.'s October report, which argued that the world has 12 years to avert catastrophic climate damage, and just needed time to get their financing in order. Regardless, the diversity of borrowers coming to market stands out as an important trend. About 39% of issuance in the first five months of 2019 came from countries other than China, France, the US, Germany, the Netherlands and Sweden, the most since at least 2014, *Bloomberg* data show.

It is important to note two things about how the corporate world is adapting to a changing climate beyond the here and now. First, working to combat it has financial rewards, encouraging more of these efforts; second, almost every big business is building climate change into its forecasts.

We can see this in the CDP's recent *Global Climate Change Analysis 2018*. As *Bloomberg's* Eric Roston reported, the world's 500 largest companies tallied \$970 billion in risks from climate change, as well as \$2.1 trillion of "potential good news" in doing something about those risks. Businesses and investors like certainty. Long-term and extremely ambitious policies such as New York's ensure a bit more certainty, even if the, exact mechanisms of achieving those policies remains uncertain. Climate change is *all that most people have ever known*, as I wrote last week, and it's the same story for global corporations.

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

**Climate change is all that most people have ever known, as I wrote last week, and it's the same story for global corporations**



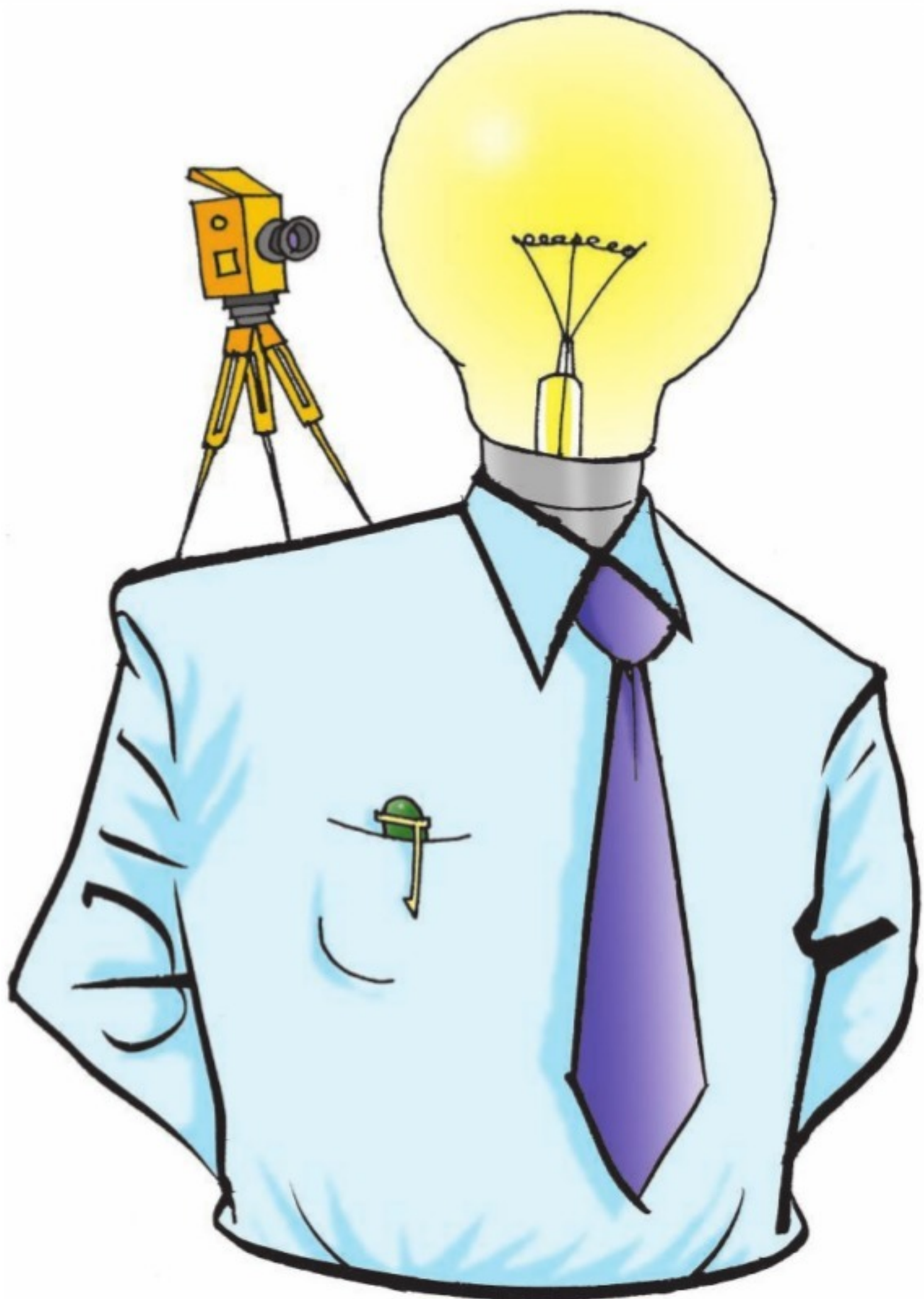


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BIKRAMJIT CHAUDHURI & SOUMYA KANTI GHOSH



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# The many pitfalls of employment surveys

Validity and reliability of statistical panel surveys, which enable researchers to study of individual behaviour change over time, are severely limited by methodological factors

**I**N 1726, AT AGE 3, Adam Smith was kidnapped by gypsies. His rescue was lucky for the world, as the discipline of economics would have been significantly different otherwise. Incidentally, the rescue is also described as lucky for the gypsies since Smith was extremely forgetful and it would have a huge burden for the gypsies to keep him captive for a long time!

Readers must be wondering why this sudden reference to Adam Smith in this article. Well, the kidnapping incident reminds us of the necessity as well as the futility of statistical surveys globally and in India. Damned if one does, damned if one does not—a necessary evil, so to say.

Statistical panel surveys involve the collection of data over time from a base-line sample of respondents. Unlike other forms of longitudinal studies, such surveys allow for the study of individual behavior change over time as the same sampling units are followed over time.

The advantage of such surveys is that they enable researchers to measure and analyze changes over time in socio-demographic and economic situations, as well as the attitudes, opinions and behaviors of individuals or aggregates of individuals. The unit of observation of household-based panels is the household and its members. Household panels enable researchers to study household change and the changing dynamics of the individuals within it. A typical example is the CMIE Household Survey.

However, though data used in such surveys have opened up avenues of research that simply could not have been pursued otherwise, their power depends on the extent and reliability of the data as well as on the validity of the restrictions upon which the statistical methods have been built. Otherwise, such data may provide a solution for one problem, but aggravate another.

Limitations of such datasets include, but are not limited to, problems in the design, collection, and management of

date for panel surveys. These include the problems of coverage (incomplete account of the population of interest), nonresponse (due to lack of cooperation of the respondent or because of interviewer's error), recall (respondent not remembering correctly), frequency of interviewing, interview spacing, reference period, the use of bounding to prevent the shifting of events from outside the recall period into the recall period, time-in-sample bias etc.

Another limitation of such datasets is the distortion due to measurement errors, which may arise because of faulty response due to unclear questions, memory errors, deliberate distortion of responses (e.g., prestige bias), inappropriate informants, wrong recording of responses, and interviewer effects. Although these problems can also occur in cross-sectional studies, they are typically aggravated in panel data studies due to their very nature.

Such datasets may also exhibit bias due to sample selection problems. For the initial wave of the panel, respondents may refuse to participate, or the interviewer may not find anybody at home. This may cause bias in the inference drawn from this sample. Although this nonresponse can also occur in cross-sectional data sets, it is more serious with panels because subsequent waves of the panel are still subject to nonresponse. Respondents may die, move, or find that the cost of responding is high.

Additionally, the data suffers from the intrinsic deficiency of reactivity. For example, if we ask people questions about the status of women at two or more points in time, the questioning process itself might produce opinion shifts. Perhaps the act of asking people about the status of women makes them more sensitive to women's issues. This increased sensitivity might mean they are more likely to favor or oppose changes in the status of women during later surveys. This is called reactivity, because the respondents are reacting to the initial questioning.

Last, but not the least, one of the most significant problems associated with panel data is the issue of attrition (i.e., respondents dropping out of the study). Attrition is a general problem for any study that draws on a panel survey. But, because of the strong correlation of attrition with residential mobility, it is a particularly severe issue for demographic analysis. Marriage, cohabitation, separation, divorce, or childbirth may lead to a residential move, and survey institutes are often unable to keep track of people as they move. A similar issue arises at higher ages, as respondents may be unavailable for an interview because they have moved into an elder-care facility, been hospitalised, or been unable to answer questions for other reasons (such as disability).

The analysis of mortality risks using a survey is also contingent on the availability of information on the reasons why a respondent dropped out. Some panel studies (like the PSID and the US Health and Retirement Survey) are able to verify that a respondent dropped out due to death by linking his or her information to official death registers. In other countries, it is not always possible to confirm deaths in this way.

Thus, such surveys, undertaken with grandiose plans and high hopes, frequently fail to live up to the expectations of the initiators of the research. Practical problems, such as continuity of personnel, institutional commitment, funding, design and substance of the databank, changing of facilities and equipment, and many others may interfere with the success of the project. We are not sure whether the surveys done by CMIE and even NSSO live up to all such challenges. A case in point is that the University of Michigan, in their Consumer Surveys, always asks consumers about their anticipation of unemployment rate changes, and that is subsequently validated. We are not sure whether the CMIE Survey, which is modelled along the lines of the University of Michigan Consumer Survey, even addresses such an issue!

## GOLD SCHEMES

# Don't just tweak, revamp them

SP KETKAR

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Both the monetisation and the bond schemes must be made perpetual, transferrable, and tradable as D-MAT bonds, denominated in grams

**W**ORLD GOLD COUNCIL, US Geological Survey and other agencies estimate that the total quantity of yellow metal on this planet is around 245,000 tonnes. Of this, 190,000 tonnes is 'above the ground stock' and 55,000 tonnes is 'below the ground'—being mined at the rate of around 3,500 tonnes per year. Break-up of 190,000 tonnes shows that 17% is official holdings of the IMF and central banks around the world, 14% is industry stock-in-trade, 21% is private investment in the form of coins and bars and the balance 48% is held as jewellery.

In India, besides the 612 tonnes' reserves with RBI, gold ownership details are not readily available. However, based on our imports in the past 30~35 years, agencies estimate that Indian households and religious institutions hold over 20,000 tonnes in coins/bars and jewellery. Our average stock-in-trade is 10,000 tonnes and we import around 800 tonnes each year.

Against this backdrop, the government launched three gold schemes in November 2015—India Gold Coins (IGC), Sovereign Gold Bonds (SGB) and Gold Monetization Scheme (GMS). Three years since, the performance of these schemes has been no match for the lure of the actual metal.

To start with, IGC sells physical gold, adding to the idle gold volume and works contrary to the overall aim of our gold policy. In any case, banks and jewellers have been selling gold coins for several years, so IGC merely means another player in that market. Moreover, given that around 100,000 IGCs—aggregating to about a tonne—have been sold in three years, net impact of the scheme on idle gold is insignificant.

For SGBs, public response has been lukewarm. From the launch of scheme, RBI has issued twenty-seven franchises of SGBs valued at ₹ 7,286 crore, which amount to around 24.8 tonnes of yellow metal. Thus, SGBs have reduced our gold imports by an average of 8 tonnes a year—which is just 1% of the annual import.

GMS has been tweaked a few times from its launch and further tweaking is reported to have been discussed last week. However, most changes such as revision of interest rates, allowing deposit for broken periods, premature withdrawal, etc, have been cosmetic, and the scheme—over three years—could bring only around 22 tonnes or 0.1% of the idle gold, into circulation. Such lacklustre performance calls for a revamp and not mere tweaking of the gold schemes.

First, gold owned by a person does not have any lock-in period and a maturity date. It continues to be with the owner, till the person sells it or gifts it. Therefore, SGBs and GDCs (Gold Deposit Certificates, issued under GMS) must mimic these characteristics of physical gold. Both need to be redefined as perpetual, transferrable, tradable D-MAT bonds, denominated in grams. The value of these bonds could be updated as per price movements in the bullion market and interest could be computed on daily balance at rates to be fixed every quarter. In fact, SGBs and GDCs could be merged into a single instrument that is realizable in rupees only, at prevailing gold prices.

Second, except for SBI and few others, banks do not mention GMS on their websites and employees are not even aware of the scheme. Banks need to share the details of GMS, such as account opening procedure, various formats, document requirements, etc, on their websites and adequately train their customer-facing employees.

Third, while banks are aggressively promoting SGBs, particularly to their D-MAT customers, they are not marketing the GMS at all. Banks need to mine their databases and promote GMS to every customer, who ever held a locker in the bank or has bought gold coins or bars from the bank in the past 10~15 years. Also, banks must educate their potential customers that just like holding gold in physical form, the quantity of gold in their SGBs and GDCs will always remain intact. Only the value of their holding will change according to changes in gold prices.

Finally, no scheme can succeed in India, by offering it through 10~15 designated branches in metros and making the customers run from a branch to a CPTC (Collection and Purity Testing Center) and back to the branch, for each monetisation request. There is an urgent need for banks to collectively cover all the 53 million-plus towns, by operating at least one branch per town that is equipped with on-premise CPTC, to offer single-window service for gold monetisation.

## NEW ECONOMY

**F**INANCE MINISTER'S ADDRESS to G20 reaffirmed India's steadfast approach to taxing digital companies. The issue of large multinationals not paying their fair share of taxation has been explicitly acknowledged, and work on this has been undertaken under aegis of the OECD's Base Erosion and Profit Shifting Program. The program, however, has taken an interesting turn. Fissures have appeared in the international tax cooperation carved out nearly a century ago. The cause for this is the re-examination of international tax rules that could potentially reallocate taxing rights. The proposals being suggested can potentially shake up the source-residence balance crafted into law. Much to the dismay of developed countries, OECD has suggested the various proposals will be examined and developed without prejudice. This is also in contrast to the beginning of the century, when the rules were first designed. Developing countries, such as India, are now at the forefront of discussions.

Digital companies, unlike brick-and-mortar companies, can sustain significant economic relations with the market jurisdictions without physical presence. Imagine an e-commerce platform. It can bring together buyers and sellers with just a website that can be hosted through a server located anywhere in the world. Tax

# Taxing the digitalised economy

Discussion on economic digitalisation must precede changes in law to ensure a level playing field and protect tax base of digital companies

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authorities have been riddled by such dislocation of taxable presence. It is a challenge to identify what qualifies as taxable presence. This question is being examined in detail by policy-makers. While developing countries, such as India, consider user participation or digital revenues as economic presence, others, such as USA, consider only a fraction of the economic profit to be attributable to market's contribution. As countries try to resolve these disagreements to find a long-term solution, India has moved ahead on its own by

implementing a series of measures. In 2016, India introduced the equalisation levy through the Finance Act. This levy is withholding on payments to non-resident companies by resident companies in lieu of digital advertising services. India is among the first to introduce this. However, the levy has been criticised widely, primarily, since it is not creditable in the country of residence. As a result, it could lead to over-taxation. As of now, for the thresholds prescribed, the tax is applicable to limited companies offering digital



advertising services.

To be able to tax digital companies appropriately in India, the Income Tax Act was amended to add an explanation to the definition of business connection, in 2018. The definition prescribes economic presence based on the user base and sales revenue. Known as the test for significant economic presence, it has so far not been operationalised. The bigger challenge is that even if it were operationalised, it would not apply unless India's tax treaties, too, are suitably amended. Further,

if a company is considered as having a taxable presence in India, it remains to be determined how much of its income is attributable to India. For example, hiring platforms may have one of the transactions located abroad. Would the entire value, then, be attributed to India? If not, then how much is the contribution of the Indian user?

Pre-empting such issues and in an effort to move ahead, CBDT recently called for comments on its discussion draft that recommends apportionment

profits on various factors such as sales, assets and users. The draft proposes that in a situation where it is difficult to ascertain the income of a company, the tax department can use existing rules of the Income Tax Act to compute tax as a percentage of turnover, or in a manner it deems suitable. A seemingly simple solution, it comes with its own set of challenges. First, this rule would be triggered only under the condition that the income is not ascertainable. To add to that, where such exact language does not appear, relevant treaties will still have to be amended. More importantly, it is necessary to develop a consistent and nuanced methodology for an acceptable apportionment.

It is commendable that India is leading discussions on digital taxes. Undoubtedly, it is important to create a level playing field and protect the tax base. However, the progress of such measures, taken unilaterally, is not unfettered. A network of treaties based on international conventions supersede the domestic law. To find agreeable solutions to overhaul this outdated system, it is necessary that the discussion on economics of digitalisation precedes the change in law. If the question of what constitutes a taxable nexus remains unanswered, businesses may get caught in the crosshairs of unilateral measures.