Opinion

WEDNESDAY, DECEMBER 25, 2019

BACK TO THE FUTURE

Union home minister Amit Shah

There is no need to debate this (pan-India NRC) as there is no discussion on it right now. PM Modi was right, there is no discussion on it yet either in the Cabinet or Parliament

RationalExpectations

SUNIL JAIN

sunil.jain@expressindia.com
@thesuniljain

Can't eat an Apple if left out too long

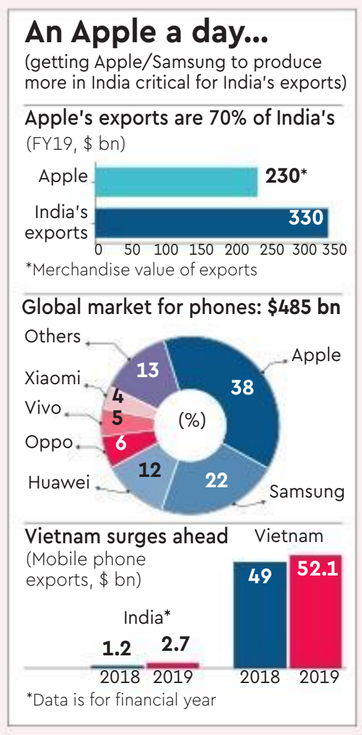
PMO wanted to exploit the possibilities from US-China tensions six months ago, but we missed it; US-China relations on the mend now

THE APPLE, MOST will recognise, is a fairly hardy fruit, but it does lose its flavour if left in the open for too long. So, it has to be worrying that little has happened even six months after the principal secretary in the PMO asked senior secretaries to make the most of "a golden opportunity (of) ... several global companies ... in China... seriously considering an alternative location." In the event, the PMO asked "that an enabling policy framework to seize this opportunity may kindly be designed".

The PMO had companies like Apple and Samsung in mind—together they account for 60% of the $500 bn global export market for mobile phones—but, six months later, when the US and China have started unwinding their aggressive trade positions, India is no closer to offering them a good reason to relocate a large part of their mobile phone production here. This, sadly, is not the only instance of the government—and not just the Narendra Modi one—failing to capitalise on the moment; that is why, between 1990 and 2018, Vietnam's exports rose 102 times from $2.4 bn (13% of India's) to $245.6 bn (75% of India's) while our exports rose just 18 times, from $18 bn to $325.6 bn.

The reason why the PMO, and others like NITI Aayog, were keen to get an Apple and a Samsung to produce in India is that though India's production of mobile phones rose dramatically—from 6 crore units in FY15 to 22.5 crore units in FY18—so did imports of components, from $11.2 bn to $21.9 bn. Were an Apple or a Samsung to shift a meaningful part of its production to India—while Apple still primarily produces out of China, Samsung shut its last China factory, which made 63 mn phones, in October—the argument was, they would shift their principal suppliers, and value-addition in India would grow dramatically.

Apple's exports out of China (iPhones, iPads, iWatches, etc), to put this in perspective, retail at $200 bn and the firm employs (directly and indirectly) 47 lakh people in the country. For its part, when Samsung—it produces around half its mobile phones out of Vietnam—moved out of Huizhou, the Chinese city turned into a ghost town due to the main factory, and its ancillaries, shutting shop; the services economy, including the rental one, built around Samsung also collapsed. While Samsung has the world's largest mobile phone factory in the world in Noida—this has a capacity of 120 mn phones—it has several more, albeit smaller ones, in Vietnam; with half its 350-400 mn phones made out of Vietnam, not surprisingly, the country's exports are over $52 bn today, or roughly 10% of the global exports market.



If India has to have any chance of meeting its exports target—the 2019 National Policy on Electronics (NPE) has a domestic sales target of 400 mn phones (worth $80 bn) and an export target of 600 mn (worth $110 bn) by 2025—a business-as-usual approach just won't do. Between FY18 and FY19, India's exports grew 125%, but they were still a mere $2.7 bn. NPE, in fact, aimed at zero net imports of electronics (including mobiles) by 2020 while the actual imports were just under $39 bn; the 2025 mobile-export target implies India is looking at a global market share of 19-20%!

It is true that Apple assembles phones in India, but doing this in, say, a Foxconn facility, without its entire ecosystem, isn't quite the same thing as there is little value addition. What makes the inability to get either an Apple or a Samsung to shift any significant part of their production setup in India even more tragic is that, even before the PMO wrote its letter, things looked like they were moving in the right direction.

Till then, while India boasted of having become a big producer of mobile phones, the truth was quite the opposite. While the government spoke of 268 units producing mobile phones/components in 2019—up from 120 in 2017—*FE* found that half had shut shop as there was little local value addition. Since the additional problem with the policy was that imports were burgeoning, in February 2019, the government came up with NPE 2019 that shifted the focus from domestic manufacture to exports, and from import-tariff protection to incentives for exports. Some months ago, finance minister Nirmala Sitharaman said she was designing policies to woo big manufacturers looking to move out of China; it was in this context that she cut the corporate tax rate from an effective 46% (including dividend distribution tax, DDT) to 15% (without accounting for DDT). The government also announced a ₹50,000 crore export incentive scheme to replace the existing MEIS and other schemes that were also falling foul of WTO norms.

While the temporary (?) patch-up between the US and China has meant that big producers in China have no immediate pressure to leave the country (with trade sanctions, their China exports would have been hit by import duties in the US); at the same time, the government has not made any concrete offer to the big mobile phone manufacturers either. Indeed, while estimates are manufacturing in India is around 19-23% more expensive than in China, and 10-12% as compared to Vietnam—due to poorer infrastructure here, and lower fiscal incentives—India has lowered the export incentives it gives for mobile phone exports; this was 4% of the value of the phone till January, when it was reduced by half, as a result of which, this year's exports are likely to be lower than last year's.

Postscript: This is, though, not the first time India has failed to seize the initiative. When China vacated the lower-end textiles markets, it was countries like Bangladesh and Vietnam that captured the markets. India's refusal to free up oil and gas markets has ensured investments in the sector remain poor; ditto for the mining sector. In the case of telecom, not scrapping licence fees in 2010—when spectrum was sold at sky-high prices—has resulted in the sector almost dying... The list of lost chances is a long one.

ToleratingINTOLERANCE

Sena's Mumbai episode, and other instances expose the intolerance hypocrisy of the political class

WHILE THE BJP is frequently accused of launching attacks against its critics online—trolling has been a standard feature—other parties are emulating this practice. Recently, some of the Shiv Sena cadre assaulted a person in Mumbai for making a post against their CM and party leader Uddhav Thackeray. According to a *Times of India* report, 25-30 people beat up the victim and tonsured him for criticising Thackeray's Jamia-Jallianwala Bagh comparison. Although Shiv Sena is not new to this kind of response—Shiv Sainiks had ransacked the hospital of the relative of the girl who had commented on Bal Thackeray's death—domineering has become common across political lines. Earlier this year, police complaints were filed by TMC supporters against a BJP worker for creating a meme of the TMC leader and circulating it on social media.

If earlier attacks targeted people hurting or insulting religious sentiments, the rise in violent responses to expression of dissent shows political leaders themselves being granted god-like status. The deification has led to party cadre getting aggravated when citizens rightfully question their leaders, having chilling effects on freedom of expression, both online and offline—in the present instance, the victim was beaten up despite having deleted the offending post following threats. In the absence of strict police action, such cases are fast becoming a menace. The amount of frivolous litigation by party supporters against those criticising political leaders has been increasing. The episode reveals the hypocrisy of even those decrying intolerance.

NCLAT's TATA VERDICT

THE ORDER OPENS UP UNRESOLVED QUESTIONS PERTAINING TO COMPANY LAW AND CORPORATE GOVERNANCE; INDIA INC MUST NOW BRING THESE INTO MAINSTREAM PUBLIC DISCOURSE

Making corporate India more democratic

MUKESH BUTANI & TARUN JAIN

Authors are Partners, BMR Legal
Views are personal

LAST WEEK, THE National Company Law Appellate Tribunal (NCLAT) pronounced its verdict in the appeals referred by Cyrus Mistry against an order of the National Company Law Tribunal (NCLT) that had dismissed the claims of him being unjustly ousted as the Executive Chairman of Tata Sons Ltd, the flagship Tata Group company. There are several takeaways from the NCLAT order, which clearly won't be the last word on this dispute. First, it reverses the NCLT order opining that the ouster was unlawful and, therefore, reinstates Mistry's position as the Chairman. The order is significant, given the debate on corporate governance.

Given the state of affairs of Indian corporates, corporate governance has oft been deliberated by expert committees and analysed academically. This is a reality that emerges if the NCLAT order is adjudged on its face value. It is replete with instances on how the five-decade relationship, and trust, broke down, leading to an acrimonious relationship between the Shapoorji Paloonji (SP) group and the Tata group. Identifying the promoters and stakeholders by name and holding them directly responsible for one of the most ignominious episodes in the country's corporate history, the NCLAT order recounts, in great factual detail, the circumstances leading to the trust deficit. Examined dispassionately, the NCLAT order is a case study that makes an intriguing contribution to an often-ignored area of company law jurisprudence—oppression and mismanagement of minority shareholders.

A student of company law attempting to enumerate the ways in which the minority interests can be oppressed or side-lined shall, thus, find several takeaways. First, stressing upon the veto clauses in the Articles of Association (AoA) of Tata Sons, the Tribunal has concluded that such clauses *per se* put minority interests in jeopardy. Second, nominee directors, who pull along the line of vested interests, can also cause oppression. Third, corporate decisions 'out of the boardroom' rendering the meetings mere rubber stamping exercises implies silencing the voice of the minority. Fourth, constant interference in executive functioning by the majority can often lead to disillusionment of senior professionals, and is another way to thwart balanced pursuit of the corporate agenda. Fifth, retribution against the executive board for taking tough and crucial decisions, repeated go-slows and pressure to turn around, cartelisation of board members, etc, are also instances that effectively undermine minority interests. Those at the fringes are also shareholders, thus, there can never be any overwhelming rationale for practices that scuttle minority interests.

This raises several questions. Are Indian companies really governed democratically? How meaningful are the roles and responsibilities of elected directors; are they expected to stand up to promoters when faced with dilution of shareholder interests, etc? While these come up routinely in corporate functioning, they are not systematically addressed. This despite the overhaul of corporate laws in the past decade—the 2013 Companies Act being the most significant—and several expert committees have made far-reaching recommendations on board governance. Even the empowered regulator hasn't shied away from exercising its power. However, no external push to evolve governance style can ever be the solution. The underlying tenor of NCLAT's order, no matter which side it endorsed, is clear: One cannot expect the dawn of professional standards in corporate management unless self-restraint is imbibed by influential board figures with an agenda, and, simultaneously, the boards are empowered to ensure businesses are managed professionally. Given that public funds are involved, it is incumbent upon the boards to keep personal prejudices aside, giving way to evolved and mature decision-making. At any rate, boardrooms should not become a wrestling theatre for testing dominance.

The NCLAT order puts a big question mark on the status of nominee directors. No doubt, they are expected to protect the interests of the institutions they represent. Does that imply, however, that interests of the entity and the shareholders can regularly be stonewalled? This is indeed a delicate balance. What happens in a situation where the interests of the institutions they represent conflict with the those of the investor board over which they preside? It is common to hold and exercise veto powers; can the exercise of such powers, if done under the company's constitutional documents, become a means of oppression and mismanagement? The NCLAT order is silent on this aspect. Nominee directors ensure that decision-making is consultative, no matter how disjoint and varied the views. Even if the order of NCLAT is overturned in further appeal, it makes a compelling case for corporate India to evolve a framework that delineates the role and responsibilities of nominee directors. This is particularly important for institutional investors, especially when they preside over large PSUs and banks. As a start, they must appreciate that written notes of dissent appended to minutes of board meetings carry significance, and instil probity in corporate functioning rather than thwarting the decision-making altogether.

> **Even if the order of NCLAT is overturned in further appeal, it makes a compelling case for corporate India to evolve a framework that delineates the role and responsibilities of nominee directors**

While the correctness of the NCLAT's order will indeed be litigated, corporate India boards and lawmakers must not lose this opportunity to reinvigorate the debate on governance and bring it into mainstream public discourse. Anecdotally, Indian shareholders do not exhibit resilience in situations of governance deficit, unlike their western counterparts. Silence in instituting probing inquiries against underperforming or digressing boards should not translate to promoter groups viewing them as gullible. In the Tata-Mistry tussle, shareholders did not have a voice (at the NCLAT), much less a viewpoint. Such trends could witness a reversal, with shareholders exercising their rights by way of class-action lawsuits, or through other legal means that impact shareholder worth when boardrooms become a battleground of warring factions.

Another issue worth pondering is the fate of the decisions taken by the Chairman and Board that stand ousted by the NCLAT order. Ideally, the NCLAT should have made corollary observations regarding the validity and consequences of the actions of the Chairman and Board. In the absence of such observations, are those decisions *per se* invalid, or will third-parties who acted upon them continue to exercise rights, notwithstanding the declaration of illegality by the NCLAT? Experts will invoke the doctrine of 'indoor management' to opine that third parties, which are not concerned with the correctness of the composition the board, would not be affected by (past) acts of the erstwhile Board. There is no assurance that past actions will not be revisited in a manner that has a bearing on the rights of third parties. This is a crucial aspect that NCLAT ought to have addressed. Finally, we wonder if the order is practical in terms of its implementation. Historically, in such situations, company tribunals have tried to find a workable solution, like a group of majority shareholders buying the minority, for instance. How practical is it for Cyrus Mistry to return, and will that be a workable solution for the Tata Group? Perhaps, both sides may work out an 'out of court' settlement.

Air India shouldn't fly past North East

The privatisation of Air India poses a challenge of integrating the North East with the rest of the country, and retaining air connectivity in the region

SATYENDRA PANDEY

Former advisor, Centre for Aviation (CAPA). *Views are personal*

AS THE DEADLINE for the privatisation of Air India approaches, much is afoot. This includes union opposition, a lack of investor interest, and an NCLAT judgment for one of Air India's suitors. The government, however, is firm in its resolve. After all, Air India continues to bleed, with no respite in sight. Its FY19 loss was ₹8,556 crore; FY20 will likely be worse. This, after the government infused ₹17,320 crore of taxpayer money over the last five years. Needless to say, the situation is unsustainable. Yet, in the rush to privatise, the connectivity to the North East may have been overlooked.

India's NorthEast (NE) comprises of the states of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, and Tripura, also known as the seven sisters. An ethnically, culturally, and geographically diverse region, the NE is connected with the rest of the country through a narrow corridor of approximately 21 kilometres. Within the NE, connectivity initiatives are underway, the most famous being the Bogibeel bridge that connects Dibrugarh to Dhemaji, supplementing the Kolia Bhomora Setu. However, such projects have long gestation periods, and are focused on intra-regional connectivity. Air connectivity, therefore, continues to be the fastest and most economical means.

This connectivity challenge was partly addressed by the poorly thought-out Route Dispersal Guidelines (RDGs). But, in a classic case of intent versus impact, airlines started plying on these routes for compliance rather than connectivity. As such, most airlines include routes that had high demand—Srinagar, Jammu, Guwahati, and Bagdogra—in their network. The structure of the network can be adjusted to ensure compliance.

When this did not work, the government, in 2016, launched the regional connectivity scheme UDAN. This included subsidies for NE routes. However, there have been few takers. In the four iterations of UDAN, UDAN-1 did not have any routes in the NE; UDAN-2 connected Tezpur, Jorhat, Lilabari, and Pakyong (Tezpur and Pakyong operations have since ceased); UDAN-3 connected Lilabari, Guwahati, Imphal, and Dimapur route, but all have been loss-making; and UDAN-4 has six airports from the NE listed as priority areas, and an additional 23 unserved airports. Several airlines have attempted to start operations in the NE, but without much success.

> **In the event of a sale of Air India, any buyer will almost certainly revisit the airline network, and the NE routes, which are operating at a cash-loss, are sure to be pruned**

Airlinks are critical to the NE from a strategic and development perspective. Air India currently has 289 daily flights servicing 57 domestic destinations. These include seven cities in the North East. Alliance Air, an Air India subsidiary, has 111 flights daily, servicing the seven destinations in the North East. These include Guwahati, North Lakhimpur, Tezpur, Pasighat, Imphal, Shillong, and Dimapur. Some of the Alliance Air flights are operated under an MoU with the North Eastern Council (NEC) and get funding support. Interestingly, Alliance has not turned a profit for several years, and most recent estimates peg its losses upwards of ₹250 crore.

The NE flights, for the most part, are loss-making due to cyclical demand, irrational cost structure, and low passenger volumes. In the event of a sale of Air India, any buyer will almost certainly revisit the airline network; the NE routes, which all estimates indicate are operating at a cash-loss, will surely be pruned. Airports that will lose connectivity completely include Lakhimpur and Tezpur in Assam, and Pasighat in Arunachal Pradesh. In others, such as Shillong and Mizoram, private operators like Indigo and Go Air will gain a monopoly status, which will impact pricing.

This poses a challenge for the government because the North East needs to be integrated with the rest of the country—this has been a core focus area politically, socially, and economically. The focus, thus, is enhanced, rather than reduced, connectivity.

As the privatisation or shutdown deadline for Air India nears, connectivity to the North East cannot be overlooked. And, this may force a revision of sorts.

LETTERS TO THE EDITOR

Partial victory

The massive student-led protests against the Citizenship Amendment Act (CAA) and National Register of Citizens (NRC) have already achieved partial victory in that they have convinced people of the wrongness of CAA and NRC, including leading chief ministers of various states to decline from participating in the exercise, and forced prime minister Narendra Modi to contradict his second-in-command Amit Shah on the NRC. Now, it will be extremely difficult for the Modi government to go against public opinion, which is clearly anti-CAA and NRC. The government of the day, or Parliament, for that matter, cannot ride roughshod over "We, the People". PM Modi, who made the veiled communal remark that arsonists can be identified by their clothes, has been forced into a climb-down on his government's ill-conceived moves, even making a statement that pan-India NRC was never on the table. The strength of the protests has forced the PM to put on hold what was planned as a major step towards India's transmutation into a Hindu Rashtra. Nevertheless, he has not yet come out with an assurance that his government has decided to shelve the NRC exercise. Perhaps, he refuses to rule it as his party has to defer to parent RSS's wish. We expect and hope that the nationwide protests will persuade the Modi government to shelve CAA and NRC, and stay away from divisive issues. Instead, we hope it strengthens national unity and tries to carry through with its promise to usher in *acche din*, raising the country's happiness index.

— G David Milton, Maruthancode

●Write to us at feletters@expressindia.com

R.N.I. Reg. No. 6188/61 Printed for the proprietors, The Indian Express (P) Ltd by Vaidehi Chintaman Thakar at The Indian Express (P) Ltd Press, Plot No. EL-208, TTC Industrial Area, Mahape, Navi Mumbai-400 710 and published from Express Towers, Nariman Point, Mumbai-400 021. Editorial & Administrative Offices: Express Towers, Nariman Point, Mumbai-400 021. Phone: 22022627/67440000. Fax: 022-22856323.
Chairman of the Board: Viveck Goenka, Managing Editor: Sunil Jain, Resident Editor: Malini Bhupta* (*Responsible for selection of news under PRB Act)

ILLUSTRATION: ROHNIT PHORE

NIRVIKAR SINGH

The author is professor of Economics, University of California, Santa Cruz

India's lost year

This was a year where India could have turned a corner, with political stability and economic recovery. Instead, the year has been lost. It is possible that India's rulers will make some course corrections, and rethink what is important for making India truly great (which is at the heart of their vision)

IN RETROSPECT, THE arc of events in India in 2019 seems predictable. Early in the year, political events afforded the government with an opportunity to highlight external threats in the general election campaign. This was arguably a major factor in giving the ruling party an unassailable majority, and seemingly, a mandate to accelerate its political and societal agenda. Indeed, this is what has happened, with actions that are well-known, including the peripheries of Kashmir and the Northeast, but ultimately reaching at the heart of the idea of Indian democracy.

Meanwhile, the economy has continued to falter, with the government seemingly always a step or two behind in what needs to be done to restore both confidence and growth. There was an interim Budget before the election, a full one after, but each with policy changes that seemed to deal with symptoms and not causes, to be reactive rather than proactive, and never quite enough.

This month is seeing nationwide protests against the latest political moves of the government, with young people leading the way in some cases. Their protests are driven by a concern for the kind of country they are going to live in for the majority of their lives. Other protests are motivated by fears of competition from immigrants. The protests are being met with police violence and internet shutdowns. It is not hard to see that the ebbing of hope in the nation's economic future is connected to both kinds of protests. India's potential demographic dividend is out in the streets, decrying the creation of fear and uncertainty about their futures, rather than moving forward with hope. And an atmosphere of fear, uncertainty, violence and repression, is not one in which economic progress is likely to thrive.

The government is clearly pursuing a well-defined, if narrow, strategic vision with respect to India's polity and society. It is proving to be bold, relentless, even rigid, in this pursuit. There does not seem to be room for debate and discussion with respect to policy choices and implementation. Centralisation and concentration of decision-making are not favourable conditions for the complex economic policy making, let alone defining priorities. The post-election statements of the vice-chairman of the NITI Aayog, regarding a priority list of "big bang" reforms, seem like a mirage at this stage. Even the pollution that choked northern India in November, harming millions of people because of poorly understood and managed economic policies, has been overshadowed, even forgotten.

> The economy has continued to falter, with the government seemingly always a step or two behind in what needs to be done to restore both confidence and growth

This was a year where India could have turned a corner, with political stability and economic recovery. Instead, the year has been lost. It is possible that India's rulers will make some course corrections, and rethink what is important for making India truly great (which is at the heart of their vision).

But it is just as possible that matters will be allowed to go on as they are proceeding, with the government's power over law and order and the media allowing it to impose its will. That course is unlikely to be good for the economy. Authoritarian regimes have certainly succeeded economically, but they are also capable of generating catastrophes. Rigid and weak democracies may also allow problems to fester, but the global evidence suggests that democracies do better on average, in terms of economic growth. Nor does India's current course bode well for its global standing or its attractiveness to foreign investors, notwithstanding the currently strong stock market.

What is the way out, so that a lost year does not become a lost decade? India's citizens will not get a chance to render a new verdict nationally for over four years, though state elections may help send useful signals to the government. But given its current mindset, it may be that only a change in that mindset will make a difference. What is remarkable in the current situation is that India, despite its diversity, is 80% Hindu. All minorities in India have navigated this dominance, and the country's political and constitutional structures implicitly incorporated this imbalance, without making it intolerable for minorities. Despite many imperfections and inequities, the Indian model seemed to be reasonably stable, and a basis for finally making serious economic progress.

Instead of building confidence and trust by embracing and strengthening the positive features of Indian society, recent political actions have been based on a mindset of fear and victimhood. Again, this is remarkable in a nation where there is such a firm majority for one religion, with an associated culture that is even more pervasive. Other countries also treat minorities badly, and blame them unfairly. There is no evidence that this approach is good for economic progress, besides its negative implications for human rights. A lost decade for the economy can stretch out further, and can be a lost decade for society as well. Indeed, the arc of history is even longer, and may bend away from progress and general well-being for many decades at a time. It is remarkable and disquieting that India is facing this prospect as 2019 comes to an end.

INDIAN I-T RATES

Not as high as they are steep

S MURLIDHARAN

The author is a CA, and a veteran columnist on taxation, finance, business and commercial laws

Let us start with 2.5% and gradually increase it by 2.5% for each slab

A FLAT RATE OF taxation doesn't sit well with income taxation because its bottom line is one-size-fits-all. One of the fundamental canons of taxation is tax according to one's ability or capacity—greater the income, higher the rate, the one that creeps up rather than shoots up dangerously. This ideal is met by progressive rates of taxation.

In 2018, Sweden's top personal income tax rate was 61.85%, Denmark's was 55.8%, and Norway's was 38.52%. Nordic nations follow a unique brand of capitalism—free enterprise, right to property, coupled with high rates of income tax so as to be able to pursue welfare economics across the board with education and health being universally free. Being peaceniks, they spend very little on defence, with Norway having no defence budget. In comparison, the Indian maximum marginal rate of 30% is not very high. On the contrary, what is questionable and needs immediate correction are the steep rates of progressive taxes in India—nil on income up to ₹2.5 lakh, 5% on income between ₹2.5 lakh and ₹5 lakh, 20% on income between ₹5 lakh and ₹10 lakh, and 30% on all income in excess of ₹10 lakh. Of course, these slabs are tweaked in favour of senior and very senior citizens. Now, 5% to 20% is a quantum jump; such leapfrogging is what encourages splitting of income.

Since income up to ₹5 lakh is completely tax-free, and it goes up significantly and steeply once you cross this danger mark, there is a natural temptation to contrive to reduce one's income to just ₹5 lakh or less. To wit, if one were to report an income of ₹5.5 lakh, he has to pay ₹22,500 as increased by education and health cess of 4%. With some tax planning, one could have avoided it by knocking off the extra ₹50,000 that is sticking out as a sore thumb. Businessmen in particular and non-salaried class in general who get considerable latitude in arranging their tax affairs would see to it that there are as many taxable units as possible, with each one not reporting more than ₹5 lakh as income. Such latitude or leeway is simply not available to the salaried class.

Contrast this with Singapore's rates, which go up gradually, almost imperceptibly, from 2% to 3.5% to 7% to 11.5% to 15% to 18% to 19% to 19.5% to 20%, before flattening out at 22%. This is as it should be. In other words, the bane of Indian tax rates is its steepness and not its highness. Let's start with 2.5% and gradually raise it by 2.5% at each slab. Let the maximum marginal rate be 40% or more to compensate partially for the resultant loss of revenue, but let it kick in at the levels of income beyond ₹50 lakh or more.

It is not only the Narendra Modi regime that is swearing by welfare economics, but other political parties across the political divide too are. Therefore, Nordic taxation should not be difficult to sell to our political class as well as people.

Upping the maximum marginal rate by 10 percentage points to 40% may not be compensation enough for the loss of revenue from making our tax rates gradually increasing. So, we may have to resort to other forms of direct taxes. Indirect taxes including GST are regressive, impacting as they do adversely the poor. Wealth tax may have to stage a comeback, albeit with a generous exemption thrown in. Late finance minister Arun Jaitley threw the baby out with the bath water when he abolished wealth tax in the 2015 Budget on the irrational ground that the collections therefrom were hardly enough even to justify on cost of collection touchstone. He should have realised that the fault with the then wealth tax regime was its selectivity—just six types of assets were targeted—whereas it ought to have targeted all assets. There is no reason why there shouldn't be wealth tax of 2% on net wealth in excess of ₹2 crore after exempting residential property or properties up to another ₹2 crore. No one is going to resent it when it is reasonable.

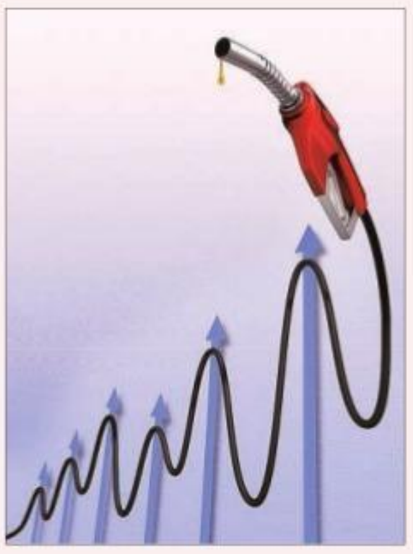
Estate duty too should stage a comeback. It has been in a suspended animation since 1985. Some states in the US impose estate duty or its variant inheritance tax almost at penal rates, close to 50% on the ground that nobody should get properties on a platter. A 10% estate duty on estate in excess of ₹5 crore cannot be assailed as excessive or unreasonable. Finance minister Nirmala Sitharaman should rationalise our direct taxes regime as above. When she does so, the charge of high rates of income tax would become muted.

Towards crude oil price hedging

What a hedged crude oil exposure would mean for the Indian economy

V SHUNMUGAM

The author is head, Research, MCX. Views are personal



WITH MULTI-YEAR high imports during FY19 estimated at 226.5 million tonnes, India is third-largest importer of crude oil, and likely to soon become the second largest. Crude oil also being the second-largest import item amounting to $112 billion, nearly 25% of India's gross imports in FY19, contributes significantly to trade and current account deficits, and adds to the vulnerabilities associated with a buyer in an oligopolistic market for crude oil—wherein supplies are managed to meet the price expectations of producers.

If imports of estimated 1,660 million barrels is hedged with an option position of, say, $64 per barrel of Indian basket crude oil (prevailing at the time of Budget 2018-19), the option premium payment obligation for one year call with an annualised volatility as in FY19 and a risk-free interest rate of 6.6% (364-days T-bill rate) tantamounts to ₹64,915 crore. Against this, the average price of Indian basket crude oil based on actual imports during 2018-19 stood about $70 (69.88), resulting in an additional cost of ₹73,083 crore to the economic stakeholders. This illustrates a potential direct saving of about ₹8,168 crore with hedging using a call option. What are the other benefits?

Researchers estimate a 10% increase in crude oil will impact economic growth numbers by 0.1-0.15%. Besides, there is a strong correlation between the inflation parameters such as WPI (0.83) and CPI (0.8) with the price of Indian crude basket. No wonder, as unhedged energy exposure would tend to permeate in various ways into the pricing of various goods and services that form part of inflation numbers.

The estimated average price of crude purchases by oil marketing companies (OMCs) gets factored into various budget estimates, including the subsidy bill. Therefore, a hedged price of crude oil and an average of the same will provide for better stability to budgetary estimates and can provide for well-planned, low-cost fund-raising by the government and businesses. A stable and predictable pricing regime will also result in lower inflation, especially when crude and its derivative products together directly account for 13.25% and 4.4% of the wholesale and consumer price index, respectively, and indirectly get priced in most goods and services, through cost transmissions through services and logistics that are energy-intensive, such as transportation. An RBI study (Mint Street Memo #17, January 2019) suggests that a rise of crude prices by $10 can push inflation up by about 49 basis points and the fiscal deficit by about 43 basis points. To the common man, a stable crude oil price regime can translate into stable fuel spend and, therefore, stable expenses and savings.

An important positive externality from contained inflation with hedged crude prices is a stable interest rate regime, which moderates borrowing costs. Empirical analysis of the past 5-year trends in inflation and interest rates indicates strong correlation between consumer price inflation and government borrowing rates—both short-term 91-day T-bill (0.64) and long-term 10-year G-Sec (0.71). With monetary policy largely dependent on the expected inflationary scenario for setting up of policy rates, the imported inflation due to pass-through of unhedged volatility in crude oil prices may drive domestic rates up, increasing borrowing costs as seen in the high crude price regimes during 2011-15. A back-of-the-envelope calculation indicates that a reduction in inflation by 50bps is likely to result in savings of ₹2,300 crore in interest costs on government borrowing.

Besides, as energy and related sectors—refining, transportation, synthetic fibres, aviation, fertilisers, plastics—constitute about 15% of GDP, any instability in crude prices impacts these sectors. Unhedged oil price not only leads to actual price pass-on, but also the pass-on of premiums arising out of price expectations of market participants, a combination that can amplify the volatility impact on prices of goods and services as they pass through several hands before they are consumed. It is the reason fleet operators, including most airlines in the developed world with healthy balance sheets, hedge their fuel exposure, providing for competitive pricing.

The culture of hedging is associated not only with the availability of suitable financial instruments, but also with access to such instruments, besides the knowledge of hedging, a state mandate, a friendlier accounting regime, a regulatory requirement for risk and risk management reporting, etc. In the absence of all these, hedging is rare and random among businesses, which explains why crude oil prices are highly correlated with inflation in India unlike in developed economies.

Another important positive externality from stable crude prices is stable exchange rate regime brought in by certainty and predictability to external trade deals and hence current account deficit.

With an understanding of the benefits of hedging crude oil prices, the question is how to fund the cost of hedging? Three possible policy options may be considered.

The first is to mandate OMCs to hedge their exposure and pass on the cost of hedging to consumers in the form of a hedging cess either directly or through appropriate fiscal measures. The second option would be to raise public funds through oil bonds at a discounted rate and a bonus linked to favourable crude oil prices movements (a 10% of MTM profits from favourable movement of prices). The third is to mandate all major user industries to gradually move towards hedging their crude oil exposures and pass the costs related to hedging to consumers.

In reality, finding a bank or treasury to offer all related hedge cover needs will not be possible and the same would need to be cultivated over a period of time through constant engagements in energy markets to seek option writer/OTC hedge provider institutions with the backing of appropriate market instruments. Meanwhile, it is crucial to develop domestic financial institutions and businesses to provide hedged covers to stakeholders in Indian energy markets, providing for development of domestic markets for OTC products.

Given the $5-trillion ambitions and a heavy dependence on crude oil imports, energy volatility would remain a key hurdle for the economy till cost-efficient hedge instruments are popularised. Hedging against volatility of imported energy products would not only stabilise spending on energy products, but also safeguard against currency and interest rate instability, and safeguarding country's energy requirements against the impact of unpredictable geopolitics and the interests of producer groups.