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GDP in La La Land?

Not all data odd with fake sales, new base & govt-spend

Official data in India has been called statistically bewildering, but never before have economists been as stumped as they were by the GDP numbers for the December 2016 quarter. The economy must have felt the pain of demonetisation, most said, so the GDP data just doesn't add up. With December GDP clocking 7% y-o-y growth versus 7.4% in September, and with GVA at 6.6% versus September's 6.7%, it would appear there has been little loss of momentum. The headline numbers suggest it is only services that have been bruised—GVA growth has moderated to 6.8% from 8.2%—pulled down by financial, real estate and professional services. This flies in the face of the data for sales of cars, two-wheelers and CVs—which contracted both in November and December—or even sales of consumer staples, cement and steel. The 10% jump in the private final consumption in December is particularly baffling even though it was festive time, or the Pay Commission bonanza ensured government employees shopped like it was going out of style and Indian weddings were still big and fat—after all, if a major part of cash was rendered unavailable, how was the expenditure funded?

But if you leave aside expenditure-side data which is notoriously unreliable on a quarterly basis, there are somewhat plausible explanations. For one, as compared to the ₹28.5 lakh crore GDP in the first estimate for the December 2015 quarter, the latest data gives a number of ₹28.3 lakh crore for the same quarter—once this new, and lower base is used, this boosts the December 2016 growth significantly, from 6.2% to 7%. Some of better performance in the December 2016 quarter can also be explained by the strong showing in the agriculture sector which grew at a bumper 6% against expectations of 5%, leaving a lot more in the hands of rural households. Also, the near-20% jump in government consumption would boost demand for a host of goods and services—this looks odd given the Centre's conservative fiscal stance, but state government spending is rising rapidly.

Though it can be argued GDP data doesn't capture the informal sector as well, financial results of 2,570 companies makes it clear the formal sector didn't do too badly in the December quarter. Net sales rose at their highest levels in several quarters while operating margins expanded by 150 basis points as the benefits of softer input costs helped lower the raw-materials-to-sales ratio by 100 basis points. In fact, ebitda-plus-employee-expenses, a proxy for GVA, rose close to 12%, higher than in the two previous quarters. Some of this blends in with the performance of the core sector which was relatively strong in the December quarter. It is also possible that, to beat the impact of demonetisation, firms showed fake sales to legitimise black money stashed away in the past, and also that some sales moved from the cash segment to the cheque one after demonetisation, and so got captured better. Since these transient factors, as well as the base-rate impact, won't be repeated in the March 2017 quarter, perhaps that will give a better sense of the demonetisation impact. It may also turn out that, thanks to the monsoon-driven agriculture boom and higher government spending—no one is doubting this data—the demonetisation impact might not be as bad as feared. Especially if tax collections rise in the amnesty scheme and significantly more people start paying their dues.

Spectrum of opportunity

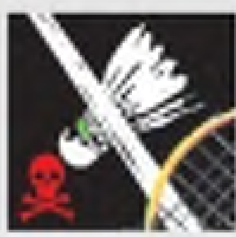
Govt policy biggest block to larger spectrum holdings

Given how critical large chunks of spectrum are for efficiency of use in providing voice telephony and, in the case of data, for dramatically increasing access speeds, it is not surprising Bharti group chief Sunil Mittal should talk of big network companies (NC) owning large amounts of spectrum that companies like his could simply rent and use. Indeed, this is the model being used for telecom towers which, instead of telcos, are now owned by independent tower companies. But if large spectrum chunks are so important, the logical question is why existing telcos aren't pooling their spectrum in the manner RJio and RCom are in the 800MHz band, even if an NC has not come up. The answer is that the law makes it difficult. If telco A buys spectrum from B, the money gets added to B's revenues on which a large licence fee has to be paid; if they share spectrum, each has to pay a hefty 0.5 ppt more license fee each year. So, till there is clarity on how license fees are to be paid—will users pay apart from what the NC pays?—no NC can come up. Also, since the law doesn't allow spectrum sharing if both telcos don't have spectrum in a particular band, this prevents optimal sharing.

Most important, with the sector in deep financial trouble, why will an NC invest in buying very expensive spectrum? Which brings you to the more important point of the need to scrap the licence fee regime if the telecom sector is to be saved. When spectrum was given out for free, it made sense to charge an annual license fee. Today, when telcos are bidding tens of thousand crore rupees each year, the burden—40% of turnover, Mittal told *The Economic Times* goes to the exchequer—is killing. It also penalises efficient telcos as they end up paying a lot more license fee than, say, a BSNL which may have more spectrum but fewer customers. If the spectrum-holding caps were more realistic and the licence-fee-regime scrapped, it wouldn't really matter if an NC came since existing telcos would buy as much spectrum as they needed to be really efficient. Indeed, till the government stops killing its golden goose, the new plan to have annual spectrum auctions will also flop since the industry will be too bankrupt to participate in any serious manner. And this is without taking into account the impact of very poor regulation by Trai that several telcos are challenging in court.

OVER THE BASELINE

BAI's junket scam shows how poor the state of sports administration in India is



WITH office-bearers of the Badminton Association of India (BAI) being exposed for fraudulently sending their kin for a junket for which only players were eligible, the rot in sports administration is now there for all to see. As per *The Times of India*, a CBI enquiry has exposed that these worthies, along with the office-bearers of the Delhi Capital Badminton Association, sent their own wards instead of badminton players on a junket to Japan in 2014. While only shuttlers who had played state- or regional-level tournaments were eligible, the office-bearers' wards had never played in any such tournament. BAI—the association's president, a former Rajya Sabha MP and vice-president of Indian Olympic Association (IOA), had sent his daughter on the junket—has claimed that it was an educational tour and there was no specific condition that only players could be sent.

This is not the first time that sports associations in the country are mired in unseemly scandals. Last year, the Indian Olymic Association had elected CWG scam-tainted Suresh Kalmadi and Abhay Chautala as life-presidents. The government may not have much muscle to cleanse BAI, given that the latter derives its powers from Badminton World Federation—very often, global sports federations view government action as interference and suspend or revoke affiliation thereby jeopardising players' futures. However, it can always order a course correction at BAI by making funds conditional. Till sports associations are not cleansed, the future of sports in India remains under a cloud.

Quotes and tablets

Decentralised planning has received lip service since the First Plan

BIBEK DEBROY

I have quoted from this book in the past, but there is no harm in quoting again. This quote is from Alexander Campbell's *The Heart of India*, published abroad in 1958. The book is "banned" in India. The word "ban" is often used loosely. This book has never been published or printed in India. The ban (Customs notification No. 49, dated March 11, 1959) is on imports into the country. It is an extremely patronising book, though that should hardly be a reason for a ban. There is a section about the author's meeting with Vaidya Sharma, of the ministry of planning. "He (Vaidya Sharma) put away the housing-development papers, and talked again about the Five Year Plan. 'We have now entered the period of the second Plan. The first Plan built up our food resources; the second Plan will lay the foundations for rapid creation of heavy industry. Delhi, as the capital of India, will play a big part, and we are getting ready to shoulder the burden. We are going to build a big central stationery depot, with a special railway-siding of its own. There will be no fewer than 12 halls, each covering 2,000 square feet. They will be storage halls, and,' said Sharma triumphantly, 'we calculate that the depot will be capable of an annual turnover of 1,400 tons of official forms, forms required for carrying out the commitments of the second Five Year Plan!'"

Richard Mahapatra is the managing editor and publisher of Down to Earth. In the current (February 16-28, 2017) issue, he writes, "Many oldtimers, gathered around a Morphy Richards transistor in a library, would react to the approval of the five-year plan, as a grave voice of the newsreader would inform about allocations. In colleges, the economics professors would read out the new priorities to students and often, shyly, hint at lucrative academic opportunities and new subjects for applying for scholarships… Not going into the details of whether planned development did any good or harm to India, the five-year plans were always good experiences." I will not get into the merits/demerits of planned development either, not only in terms of historical context, but also its continued relevance/irrelevance. (In view of the Campbell quote, perhaps I should have said reverence/irreverence.) As students, we were reverently taught, and studied, Plan models. I don't know if this reflects my jaundiced view, but the charm of Plan models probably died out with the Fourth Plan (1969-74), at best the Fifth (1974-78), if one stretches it a bit. Once rolling plans (1978-80) got going, Plan models gathered moss. Incidentally, the number of equations in any Plan model was almost entirely driven by the computing power one could rustle up.

In our student days, we rarely read Plan documents and we certainly didn't read Annual Reports of the Planning Commission. Let me now quote from the 1977-78 Annual Report of the Planning Commission, during the rolling plan era. "The Commission has suggested two new developments in the evolution of the country's planning methodology, viz. (a) the adoption of the rolling plan system and (b) the preparation of comprehensive area development plans at the block level… Year-to-year targets will be set for sectoral outlays and output for major sectors within the Five Year Plan; performance against these targets will be reviewed annually… There is no basis for the apprehensions expressed that the introduction of a Rolling Plan system would mean abandonment of long-term objectives, reducing the commitment of resources for development, and freeing the implementing agencies from any accountability for non-achievement of targets. The modifications proposed will not mean either the abandonment of perspective planning or the replacement of the discipline of a five-year framework by *ad hoc* annual decision-making. A new 15-year perspective plan will be prepared for charting the longer-term course of development of the economy as a whole… The Perspective Plan would provide the framework for investment decisions in long-gestation projects for which a five-year horizon is inadequate, and for planning for land use, water resources, oil and mineral development and manpower." I have refrained from quoting from the sections on decentralised planning sections. In hindsight, both ideas seem prescient and both have rationale, though Vaidya Sharma wouldn't have approved.

In its heyday of modelling, Planning Commission didn't have access to even mainframes. Decentralised planning now seems to replace it in every district with what are now called tablets

Decentralised planning lacks the raw appeal that centralised mathematical models possess. Even now, students are fascinated by the Oskar Lange kind of idea of a central planning board completely replicating the market through a tatonnement process. Note that decentralised planning has received lip service since the First Plan (1951-56). District Development Councils were formed, Planning Commission formulated guidelines for district planning in 1969. A Manual for Integrated District Planning was prepared by Planning Commission in 2009. The last quote is from that Manual. "From the late sixties to the mid-eighties, the trend was towards greater centralization of administration. Due to the absence of concerted political and administrative support, Panchayats had by the late sixties been superseded in most states. The formulation of Centrally Sponsored Schemes (CSS), implemented mainly through line departments led to the virtual collapse of the district planning process. Though there were several efforts to stem the tide, (Dantwala Committee, G.V.K. Rao Committee), these were largely unsuccessful." The supercomputers of the 1970s were primitive. Forget those, in its heyday of modelling, Planning Commission didn't have access to even mainframes. But that remained the aspiration and decentralised planning seemed to replace it in every district with what are now called tablets.

The author is member, NITI Aayog. Views are personal

Favouring the small and the marginal

The Discovered Small Fields policy is a masterstroke by the govt in bringing about change to India's oil sector

BHAMY V SHENOY

THE NDA government deserves much praise for the way it has implemented the policy of Discovered Small Fields (DSF) 2015 so far. Under this policy, there is no cess on crude oil, no upfront signature bonus, marketing and pricing freedom, no carried interest by NOCs, etc. These are attractive terms, indeed. But these are the very fields which ONGC and OIL assessed to be too marginal for them to develop economically.

It is for the first time that upstream contacts will be signed, based on a revenue sharing agreement (RSA) and not profit-sharing agreement (PSA). While RSAs are easier to manage than PSAs, there are still potential problems in ensuring companies secure the best market price. Let us hope that just like the NDA awarded DSFs on a transparent basis, it will institute a foolproof process to ensure minimum leakage while managing these contracts.

On February 15, Cabinet Committee on Economic Affairs has approved the award of 31 contract areas to 22 companies. Of these, four are PSUs and 15 companies are new entrants (37 new entrants bid for the fields); this is the remarkable feature of the DSF policy. Despite the road-show around the world by petroleum ministry, only one foreign oil company was among successful bidders. This should not be considered as a failure since these are marginal fields, and there is considerable uncertainty of recovery.

The Directorate General of Hydrocarbons (DGH) has estimated that oil companies may find about 40 million tonnes of oil and 22 billion cubic metres of gas in these 31 fields. An economic modelling of these fields, based on the reserves, give only about 15% rate of return on an investment of ₹36,600 crore and net present value of ₹9,000 crore. By no stretch of imagination can this be said to be commensurate with the risks investors are taking.

Even though exploration risk has been eliminated and these are all proven reserves, risk in terms of developing them remains. Actual reserves may be less than the preliminary estimate. Cost of development may be far more than expected. On the other hand, there are also chances that actual reserves may turn out to be far more than expected. Also, using better technology and greater expertise, oil companies may succeed in getting higher returns than the average estimate of 15% based on my model.

When a company gets such high returns, hopefully neither the critics nor CAG will jump to the conclusion that the government favoured such companies. Such baseless allegations though done with the right intentions may discourage future investment in India's oil sector.

When BP bought 30% share from Reliance paying $7.2 billion in the KG Basin D6 block, situation was similar to these 21 companies investing in these 31 DSFs. One can argue that it was much better in KG-D6, since it was already a production field and BP is mega-integrated oil company with considerable expertise. Despite the sophisticated analysis BP must have done in evaluating KG-D6, based on the results so far, BP may turn out to be a loser.

One needs to appreciate that all 15 companies have taken calculated risk by investing their capital. When and if they win above average returns, they do deserve such a "prize" assuming all of them fully comply with all the laws and regulations. For the first time, the Indian government has created 15 new upstream companies and, if at least few of them succeed, we need to celebrate their success and not find fault with the government.

Since these new entrants may not have requisite experience, the petroleum ministry may try to help them by setting up an advisory group of experts. Such a group can help these companies in several areas. Meeting environmental regulations is one critical area. Another area is helping get technical expertise to develop these fields in the most economical way. Every help should be given to get all the required permits without any hurdles. This can go a long way in developing these fields in the shortest time possible.

Let us not forget the unfortunate story of Ratna and R-series oil and gas fields which would rate as one of the saddest chapters in India's oil history. They were discovered by ONGC and were considered as marginal (had about 12 million tons of oil), therfore given to an Essar-led consortium in 1996. For one reason or the other (mostly concerning royalty and cess), these fields remained undeveloped for several years till 2016. Had they been developed as envisaged, they would have contributed in some measure to India's energy security. The petroleum ministry should learn from the bitter lessons of Ratna and see that history is not repeated with these 31 fields.

While NDA deserves praise for its progressive steps to reduce petroleum subsidies, it has come under attack for its policy of merger of state-owned oil companies to create a giant, integrated oil company, as also forcing ONGC to buy the KG basin assets of GSPC. It is to the credit of the petroleum minister who later watered down the policy to form a holding company by ONGC taking over BPCL or HPCL. Even this proposal has questionable value. But in the case of DSFs, NDA's policy is sound. What NDA has done may look like a small step in promoting India's energy security, but it is a big leap in bringing about structural changes in India's upstream sector.

The author is former senior manager, Conoco, and former board member of the national oil company of Georgia

LETTERS TO THE EDITOR

What demonetisation gains?

Finance Minister Arun Jaitley's curious statement as reported in the news item "Demonetisation process almost complete: Jaitley" (*FE*, February 26) is an infuriating assessment of the mammoth monetary exercise purportedly undertaken to cleanse the economy. This statement changed the narrative from excision of corruption to a simple act of replacing soiled notes with freshly printed. For that to happen, the exchequer shed a generous sum between ₹12,000-17,000 crore. After enduring the prickly heat of the liquidity crisis in the chilly winter, created by the financial harakiri, people look forward to some clarity in the conjectures advanced: the amount of ill-gotten and unaccounted money found in secluded havens, counterfeit currency notes purged, and the ban impact on the terror machinery. However, the aggressive administration ardently keeps the relevant data under wraps. On counterfeit notes, the baffled government is caught between surmise and surprise. And the less said the better about the terror fear. In the first 50 days of the current year, the country lost the precious life of 29 soldiers in terror strikes on armed forces. Near Kanpur, on the November 20, 2016, the Indore-Patna Express skidded off the track, leaving 150 dead and another 100 injured in a terror act. Recently, in the midst of a rabble-rousing election speech, the prime minister confirmed the terror angle to the rail accident. And now the FM has declared the demonetisation jamboree as closed. Beating his own drum, the Union minister Venkaiah Naidu laments, the ruling BJP has failed to take the positives of the demonetisation [BJP couldn't take plus points of note ban to masses: Naidu (*FE*, February 26)].

***Haridasan Rajan**, Kozhikode*

Trump and press freedom

It is no secret that there is no love lost between US president Donald Trump and the US media. The president has blasted media criticism to look more and more like a megalomaniac. Obviously, he has targeted those media establishments capable of resisting his regressive agenda and termed the news channels and publications that do not share his world-view as 'enemies of the people'. It is a sign of his rocky relationship with the media that he has bowed out of the White House Correspondents Association's dinner. By blasting 'fake news' and debarring select media outlets from the White House's daily press briefing, Trump has changed the picture of the US as a beacon of free speech for the whole world. The US is now lampooned, thanks to Trump's stance on media role and media freedom. The fourth estate in India doesn't have to face such a problem for the simple reason that it, by and large, supports the 'nationalist' government and what it does with 'India First' as its credo.

***G David Milton**, Maruthancode (TN)*

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Record caFE **KV PRABHU**

Joint director (research), IARI

Leave it to the farm folk

KV Prabhu, joint director (research) at Indian Agricultural Research Institute (IARI), Delhi, is a well-known plant breeder. He has contributed to the development of 23 varieties of rice, wheat, mustard and barley, including popular ones like Pusa Basmati 1121 and 1509 and HD 3086 (wheat). In an interview with **Vivian Fernandes**, *Prabhu talks about the safety and utility of a technology deployed by a team of Delhi University (DU) scientists to create mustard hybrid DMH-11. It uses a foreign gene, barnase, to create male sterility in largely open pollinating mustard, and another foreign gene, barstar, to restore fertility after cross pollination of an Indian mustard variety with an east European one.*

Portrait: SHYAM

It was in 2015, that the DU team applied for permission to cultivate DMH-11 in farmers' fields. It has missed the 2016 *rabi* planting season. In its summary put out for public reading, the sub-committee of the Genetic Engineering Appraisal Committee said the hybrid was safe. The environment minister has told the Lok Sabha that the hybrid has "adequately addressed" safety concerns. But approval for commercial cultivation is not in sight.

It was good that the dossier was put on the environment ministry's website for public knowledge. A good number of people reacted to it; almost 800 from different walks of life. The heartening point is that a large proportion—more than 85%—were able to understand its goodness and suggested we must try it out.

Does the display of a summary of the bio-safety risk assessment dossier, in your view, meet the standards of transparency?

Oh, yes! The document deals with every point that was contended and gives clarifications.

Have we followed the world's best practices in this aspect?

Yes. To the best of our knowledge, the trials were conducted as recommended.

Those who are suggesting precaution say there are other non-transgenic ways of creating mustard hybrids like cytoplasmic male sterility (CMS). So, what is the need for transgenic barnase-barstar system?

Barnase-barstar system enables perfect hybrid development. In CMS-based hybrids, we need a male sterility line, a sterility maintainer line and a fertility restorer line. Grain-setting to 100% levels are not likely to happen. The maintainer line takes a minimum of five years to develop. Which means you need be lucky to get big margins of hybrid heterosis (hybrid vigour) in order to sustain. Every time a new hybrid combination is developed, you need to convert one into a male sterile parent and its maintainer, and convert the other line to possess the fertility restorer gene, keeping the rest of the parental constitution as near to the original as possible. This is very cumbersome and time-, resource- and land-intensive. With barnase-barstar, once a parental line pair is identified as being capable of heterosis for yield, we can quickly transfer the genes using recurrent back-cross breeding method and in three years get many parental combinations converted for testing a large number of hybrids. There is a better chance of getting a superior hybrid.

Those who are not convinced about DMH-11 say the yield is not as high as claimed. Hypothetically assuming this is so, would you still go ahead with it, because the advocates say better hybrids can be created with better parental lines, once the system is approved? We need approval for the transgenic barstar-barnase hybridisation technology first before high yielding hybrids are created.

You have scored full points on this. As a plant-breeder, I see it this way only. It is the same case in every successful hybrid whether it is single-cross maize or sorghum, pearl millet or rice. Even there the first set of hybrids had hardly 7-8% yield increment. But the system was understood as having potential. Once the hybrid seed production system was established, you developed more parental combinations and tried to identify the best among them. That exercise has never been done with DMH-11 as of now. We are still in infancy. I believe the systems functionality is without doubt perfect.

What about safety to humans, animals and the environment?

All the safety issues have been taken care of. The question of herbicide tolerance is not going to be a problem in mustard because it is not going to cater to any weed that is going to be controlled by the bar gene or by Basta herbicide. (DMH-11 has the bar gene which makes it herbicide tolerant. This gene has been inserted for selection of transgenic mutants: when sprayed, only genetically-engineered ones will survive).

> The farmer is the boss. No farmer will buy something that will not give her economic yield. You cannot fool the farmer more than once. Her decision is the final decision, multinational or no multinational

Why?

Because Basta is not a recommended herbicide in India. It is not used in normal agricultural practices.

Even those who support transgenics fear MNCs will end up controlling India's agriculture because they have an edge in this field of science.

I do not bother about this MNC versus nationalist stuff. It is a trade game as in every other product and commodity. It should be in agriculture too, just as Samsung and iPhone are acceptable in competition with Micromax and other Indian brands. I take it as a challenge. As far as rice and wheat breeding is concerned, we will not only give MNCs a tough fight, we will win. We must take up the challenge here, too. If they are allowed to come in, we must accept their superiority if indeed they are superior. Or do not allow them in at all. Once you have allowed them to operate in India, we must forget they are MNCs. They have come in and are serving the country. They have to survive in the market. They can't monopolise and do what they wish and still survive. The farmer is the boss. No farmer will buy something that will not give her economic yield. You can't fool the farmer more than once. We must respect the wisdom and knowledge gained by farmers through their own experience. Their decision is final, multinational or no multinational.

Is IARI using this technology to address problems that cannot be conventionally dealt with?

We have identified 13 priority crops out of 35. In those priority crops we want traits that cannot be bred through conventional methods.

For example?

For brown plant hopper and yellow stem borer in paddy, spot blotch in wheat and pod borer in chickpea (*chana*) and pigeonpea (*tur*), we have no option but to look for this. In brinjal, for fruit and stem borer, we have no resistance in any of the native evolved materials. People who cultivate brinjal will know. Those who say on the streets that we are causing disbalance don't know the amount of pesticide that goes into the brinjals they purchase from the market. In my own kitchen garden, if I do not spray once every 12-15 days, the brinjal is bound to have a fruit borer inside.

Because transgenics minimise pesticide use, are you saying they are good for biodiversity?

This is a misdirected argument, biodiversity versus transgenic. There is no relationship at all. When you are handling transgenic material in a highly regulated environment, when every single packet that is sold is tracked, there is no question of biodiversity loss.

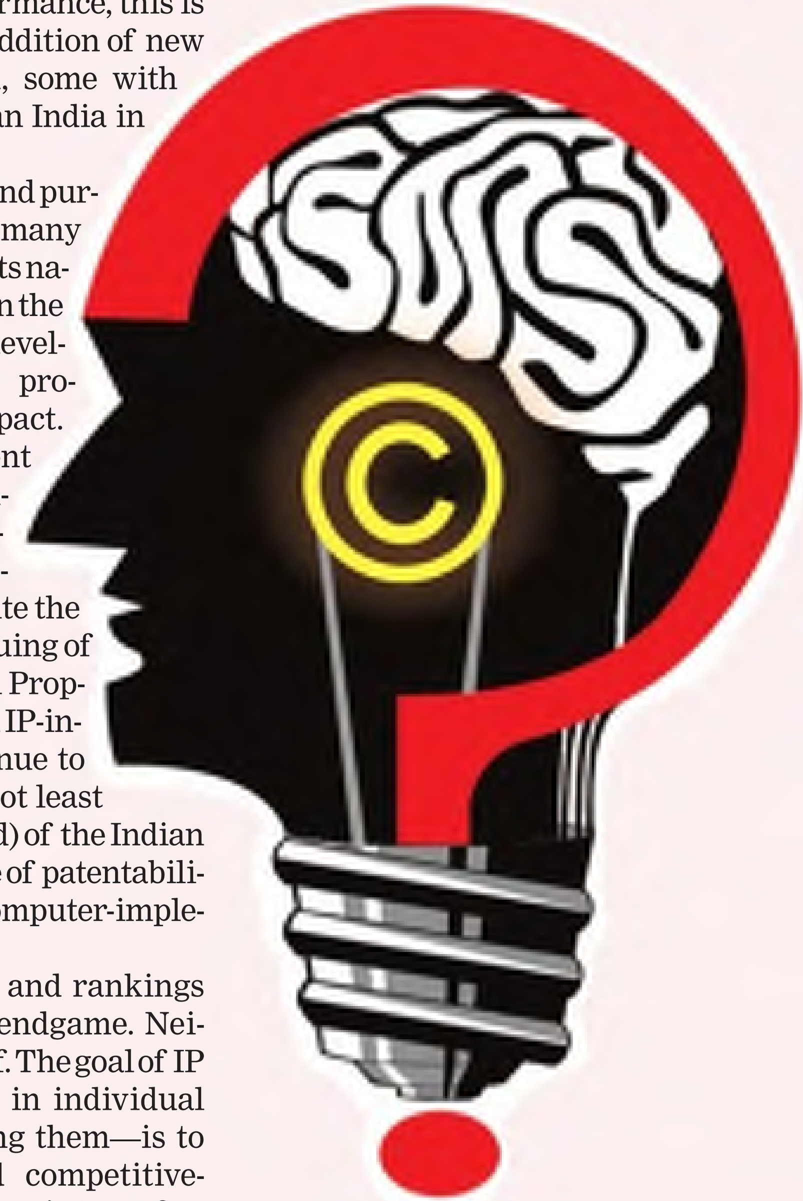
Fernandes is editor of www.smartindianagricuture.in

India's weak 'I'

The country still underperforms on metrics of innovation, investment and competitiveness

MEIR PEREZ PUGATCH

LAST month, the US Chamber released the fifth edition of the International Intellectual Property (IP) Index, which benchmarks IP standards in 45 economies around the world. In this edition of the index, India places third from the bottom—though an improvement on last year's performance, this is in large part due to the addition of new economies to the index, some with weaker performance than India in certain areas.



In fact, for all intents and purposes, India did not make many actual improvements to its national IP environment. On the contrary, a number of developments have had a pronounced negative impact. One example is the recent High Court of Delhi decision regarding photocopying copyrighted content. What is more, despite the Indian government's issuing of the National Intellectual Property Rights Policy in 2016, IP-intensive industries continue to face major challenges, not least with regard to Section 3(d) of the Indian Patents Act and the scope of patentability for life sciences and computer-implemented inventions.

But the index scores and rankings themselves are not the endgame. Neither is IP protection itself. The goal of IP protection globally and in individual economies—India among them—is to secure innovation and competitiveness, and the socio-economic transformation these provide.

One can debate the validity of a given index and ranking on IP rights—whether it is the IP Index or another measure—but the fact remains, the true test of India's IP framework is the extent to which it is delivering on the country's innovation and competitiveness goals. In the Make-in-India Strategy from 2014, the Modi administration clearly identified the growth of India's local high-tech sectors through foreign investment and increased domestic research and development as a key priority.

Yet, after two years, India still underperforms on different metrics of innovation, investment and competitiveness. For instance, India exhibits just 60% of the knowledge and technology outputs that one of its peers, China, does, as measured by the 2016 Global Innovation Index's Innovation Output Sub-Index. And while still low, China attracts double the amount of biomedical investment in terms of clinical trial activity compared to India (which, though rising, displays a rate of just over 2 trials registered in the international database *Clinicaltrials.gov* per million people). For its part, despite facing critical challenges in its IP-related laws and enforcement, China's IP framework provides patenting fundamentals that are missing or uncertain in India's IP framework.

Indeed, one common denominator of economies that do exhibit high rates of investment and innovative output is a supportive IP environment. In fact, of the 21 socio-economic indicators examined in the statistical annex of the IP Index in 2017—ranging from R&D to job growth to access to technologies—they all display a strong correlation (having a correlation strength of 0.6 or above) with the index scores. And digging into these correlations, it is clear that even an incremental improvement in IP protection can yield economic rewards and allow economies to progress toward strategic goals.

The recent National IPR Strategy was a missed opportunity to resolve the statutory and legal uncertainty undermining India's ability to strengthen innovation and competitiveness. The IP Index presents a playbook of measures that, when taken, will support India's ability to secure its socio- economic goals. What matters is whether India will keep its eye on these goals and go the full distance to secure them.

> The recent National IPR Strategy was a missed opportunity to resolve the statutory and legal uncertainty undermining India's ability to strengthen innovation and competitiveness. The IP Index presents a playbook of measures that, when taken, will support India's ability to secure its socio-economic goals

The author is a professor of intellectual property, innovation and entrepreneurship at the University of Maastricht and managing director of Pugatch Consilium. Views are personal

MUTUAL FUNDS AND COMMODITY DERIVATIVES

A high-stakes game

The move to allow MFs to trade in commodity derivatives in an organised "casino" manner is uncalled for at this nascent stage of commodity exchanges

MADHOO PAVASKAR

THE Indian mutual fund (MF) industry, with UTI as lone asset management company (AMC), has come a long way in the last 15 years. Assets under management of the industry swelled to over ₹17 lakh crore in 2017. The MF schemes are essentially collective investment schemes (CIS), wherein the money of many small investors is pooled in a large corpus, and is governed by Sebi's specific rules and regulations.

The objective of different MF schemes has been to undertake appropriate investment activities. These investments are carried out on the advice of experts, who take into account the potential risks. Efforts are made by the MFs to integrate, reduce, and avoid or manage not only speculative, but also systemic, risks intrinsically involved in such investments by executing simultaneously the corresponding futures or options contracts.

It is seen recently that Sebi, in its new avatar as a regulator of commodities derivatives market—post-merger of FMC with Sebi—has been aggressive, and, as per news reports, MFs may be allowed to trade in commodity derivatives. This is not in accordance with the objectives of MFs, and may turn schemes into organised speculative funds, notwithstanding the fact that public money is deployed through CIS.

As it is, since the advent of MFs in the securities market, Sebi has come out with various regulations from time to time to protect the retail investments in them, and also the market at large. Sebi had always taken a calibrated approach in regulating short selling of securities by institutional players like mutual funds, for fear of excessive speculation and threat to market integrity. Short-selling is the sale of a security that the seller does not own at the time of trade. Sebi had initially prohibited institutional players, including MFs, from short-selling of securities. However, subsequently in 2007, it allowed them to execute short sales of securities, but under certain conditions.

Unlike in stock exchanges, if MFs were allowed to trade in commodity derivatives market, Sebi will have to face a mammoth task in framing and issuing guidelines and norms for mutual funds to protect the market integrity of commodity exchanges. This task will be all the more necessary because commodity exchanges don't have well-organised parallel physical markets. The existing physical markets are unorganised and their functioning shrouded in secrecy. Note, although commodity derivatives contracts, they are speculative in nature as volumes outweigh the hedging trades.

On the other hand, there is an active and organised equities segment, along with the F&O segment in securities market. Hence, MFs are allowed to trade in both, provided they maintain a healthy balance between trades.

In the commodity derivatives market, MFs won't have any exposure to the underlying physical market, unless these are organised and well developed. So, they will be indulging in only speculative trades. If they choose, they may, however, enter the present unorganised and for solely speculative purposes, unregulated physical markets in commodities, as there are no restrictions on short-selling in those markets. Such short sales of the MFs in physical commodities can only be speculative, as they have little interest in either accepting or issuing physical deliveries of commodities *per se*, without warehousing facilities. If they do trade in unorganised physical markets, they can influence their prices and, consequently, manoeuvre derivatives market prices. The participation of MFs in commodity derivatives market, thus, will result in risk escalation rather than containment of their investment portfolio, violating the basic theory of mutual funds. Even if MFs were to trade only in the commodity derivatives markets, without any underlying commitment in the physical market, they will cause roguish high volatility in the prices of derivatives, and even aggravate price trends in those contracts, impairing their utility for price discovery and price risk management. Trends in exchanges will affect the economy through impact on inflation.

> Allowing MFs to invest in commodity derivatives would sound their death knell and wipe out retail investors' savings

This is not all. In the past, the government had banned futures trading in several commodity derivatives contracts, owing to an increase in prices following speculative excesses. With the infusion of funds from the MF schemes, the need for such drastic measures will be felt all the more. They will adversely impact the retail investors and put their investment at undue risk.

Unlike the securities market, which impacts only a fraction of the economy, the commodity market has a far-reaching impact. Likewise, whereas the equity market is aimed at value creation and investment generation, the commodities market is needed for creating a salubrious balance between the supplies of commodities and the demand for them.

It is already well-recognised that commodity derivatives, as an alternative investment asset class, are far riskier than traditional assets. Commodities underlying their derivatives are mostly seasonal, often perishable, and call for investment in vaults, warehouses or cold storages, besides being subject to various central and state taxes and levies. Moreover, many of the underlying commodities, including metals and energy products, are imported and exported and, thus, their demand is subject to global influences. That renders commodities vulnerable to unforeseen and unpredictable price fluctuations, aside from government interventions in the form of customs duties, and the application of the Essential Commodities Act to prevent hoarding. Unsurprisingly, such inherent high risk-high return characteristic of commodity derivatives may only encourage MF managers to park larger funds in them.

True, Sebi may be considering the entry of mutual funds in commodity derivatives markets to enhance their depth and liquidity. But the lack of liquidity in commodity exchanges at present is largely due to the high transaction tax on non-farm commodities, including processed farm products (Madhoo Pavaskar, *Commodities Derivatives Trading—Theory and Regulation*, Notion Press, 2016, Chapter 26, pp.225-230)

Allowing mutual funds to trade in commodity derivatives contracts is not the solution for the lack of liquidity in commodity exchanges. So, Sebi should scrutinise the need for permitting MFs to trade in commodity derivatives contracts. There are other ways to improve the liquidity of commodity derivatives markets. Sebi should resort to them before rushing to permit the entry of MFs

In short, the move to allow MFs to trade in commodity derivatives in an organised "casino" manner is certainly uncalled for at this nascent stage of commodity exchanges. Permitting MFs would sound the death knell of the funds, besides wiping out the savings of lakhs of poor retail investors.

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