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Shady money

Singapore and Mauritius FDI, govt says, isn't kosher

With the rupee crossing 55 to the dollar, the current account deficit at record highs and both FDI and FII inflows looking iffy, the government is unlikely to do anything to disturb the status quo, but it's interesting that its white paper on black money says both Singapore and Mauritius which account for half the FDI into India are likely conduits of black money. "Mauritius and Singapore with their small economies", the white paper says, "cannot be the sources of such huge investments … investments are routed … for avoidance of taxes and/or for concealing the identities from the revenue authorities." A similar sentiment is expressed in connection with Participatory Note investment through FIIs: "the ultimate beneficiaries … can be Indians and the source of their investment may be black money generated by them."

The interesting part of the report which does not actually give the latest government estimates of black money—these will have to wait for the study of three research organisations by the end of the year—is that it debunks many estimates of black money. To begin with, it points out there is no such organisation as the Swiss Banking Association whose 'report' many cite and instead quotes a report by the Swiss National Bank which says the total deposits by Indians in Swiss banks stand at ₹9,295 crore and account for just 0.13% of all Swiss deposits. As for the Global Financial Integrity (GFI) report which says India's black economy equals half the total economy, the white paper says "it accepted … the back-of-the-envelope method method … was flawed." Indeed, the wide discrepancy between GFI and IMF/World Bank estimates suggest the same thing. While it's a good idea to wait for the new research studies on black money, it does seem difficult to get anywhere near the huge numbers based on the GFI report being cited by people ranging from LK Advani to Baba Ramdev today. Even if you go by the estimates of the black money component in real estate, this doesn't give you a figure of more than 5% of GDP; if you assume all gold consumption is black money, that doesn't give you more than 2% of GDP as black; if all FDI equity inflows through Mauritius (42%) and Singapore (9%) are considered to be black, that's still a very small number at an average of $10bn a year from the year 2000 till now …

Thankfully the white paper seems to come out against more amnesty schemes including one of gold bonds that is being talked of today, arguing that this creates a greater incentive to avoid taxes. It plumps for greater transparency in allocation of natural resources (₹1.76 lakh crore loss on telecom and ₹10.7 lakh crore on coal, going by CAG figures) and greater effort by the taxman—to cite one figure in the paper, while 11 crore entities have PAN numbers, just 3.5 crore file taxes. Indeed, as a recent CAG report points out, tax buoyancy has fallen dramatically from 2.5 in 2006-07 to 0.7 in 2010-11. India's most successful amnesty, VDIS-97, unearthed ₹33,697 crore of black money, around 2.2% of that year's GDP. Raising the tax-to-GDP rates by just 0.5% will get that much today, and a lot more each year, given how GDP is growing.

Short-circuiting reforms

Regulators prevent buyers from finding new suppliers

With losses in the power sector likely to be around ₹80,000 crore in FY12 (₹2 lakh crore in terms of accumulated losses), and peaking power shortages at over 10%, and the government working on yet another bailout scheme that involves RBI funding an SPV which takes over bad debts of SEBs, who is to blame? The question is of vital importance, not just for power producers who added 12,000 MW of fresh capacity last year, but also for banks who have lent ₹3 lakh crore to state utilities and have recast ₹75,000 crore of this.

As *FE* reported on Monday (*http://goo.gl/I0RDr*), while 'open access', or allowing buyers to move to other producers, was supposed to be the centre of the turnaround strategy for the sector, state-level regulators appear to be doing their best to stop this. Under the Electricity Act, when a firm switched from one power supplier to another, it was to pay an open access surcharge to compensate the power supplier for the fact that a good customer was moving away—this surcharge was to take care of the losses suffered due to theft mainly. But with state regulators levying open access charges ranging from ₹1.20 per unit in Himachal Pradesh to as high as ₹2.35-2.68 in Tamil Nadu and West Bengal, it becomes cheaper for buyers to stick to the original supplier, making a mockery of the Electricity Act and its mandated provisions for open access. Hopefully, with the central electricity regulator now mandating state regulators have to examine the need to raise tariffs each year and to be more strict with provisions for allowing open access, things will improve—there's 100 GW of potential new power capacity in the next 5 years at stake.

HOMEWARD BOUND

US companies are beginning to shift operations back to the US; good for Obama, bad for India

US President Barack Obama's last State of the Union speech before the 2012 elections largely focused on strengthening the economic home front by providing tax incentives to companies that invested in the US, and tax disincentives for those who chose to outsource their operations. Even though these tax proposals haven't come into effect yet, according to a survey by consulting firm Accenture, the desired effect is taking place nevertheless—according to the survey, around 65% of the senior executives of American companies surveyed said that they had moved operations in the past two years, with 40% of those saying they had relocated to the US. Re-shoring, as this trend is called, has been on the cards for a while, with the Boston Consulting Group (BCG) predicting in May 2011 that "within the next five years, the US is expected to experience a manufacturing renaissance" due to rising wage rates in China and the increasing global competitiveness of certain regions in the US. According to BCG, wages are climbing at 15-20% a year across China due to a supply-demand imbalance for skilled labour, and that perhaps answers why only 28% of Accenture's respondents said they had relocated there. MIT, which has also analysed the re-shoring trend, says that high energy costs (which make shipping more expensive) have also induced the shift back to the US.

As Boeing's CEO Jim McNerney (a major proponent of strengthening US manufacturing) said earlier this year, American companies, 'lemming-like', moved their operations abroad over the last 15 years in search of lower costs, and thus suffered in terms of quality and service, two elements that companies moving back to the US want to address. But, as more companies move back to the US, its their erstwhile locations—China, India, Mexico, etc—that will suffer. With an already flagging international reputation, India would do well to take heed of this trend.

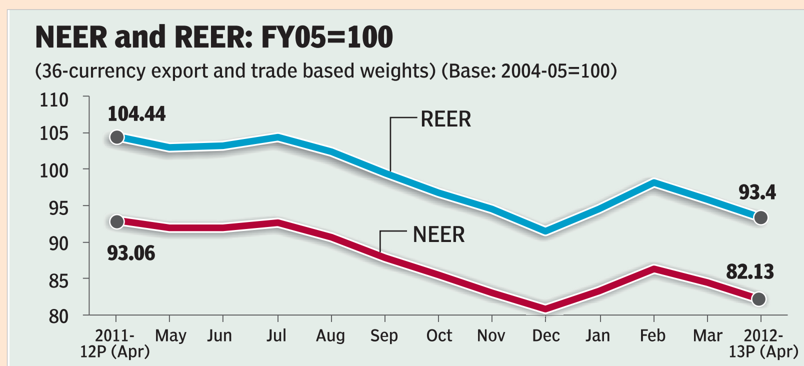
Don't defend the rupee

Apart from worsening fundamentals, the rupee is being driven by the €-$ relationship that RBI can do little about

When the rupee is volatile and there seems to be no sign of light at the end of the proverbial tunnel, it makes a lot of sense to let things be as they are. RBI has limited ammunition to defend the rupee and any kind of sale of dollars gets absorbed soon and the situation reverts to the status quo. And the pockets are not deep.

The rupee is being driven by fundamentals as well as extraneous conditions. Within fundamentals there are two sections. The first is the current account deficit, which is under pressure, being close to 4% of GDP—though the exact number prevailing in May is unknown. But we do know that exports could be slowing down while imports are stable largely due to declining gold imports and lower oil prices. Invisibles could be marginally better, and hence the deficit could at best be stable.

Looking at the capital account, there are four elements that can change the face. FDI has been buoyant last year, and will be steady. FIIs are still suspicious and there are outflows rather than inflows. NRI deposits are largely steady and inelastic and RBI has allowed for better returns to induce more flows. ECBs are useful, and RBI has been liberal here. But, companies will not be borrowing now as this is the non-peak season. Also, there is little investment taking place, and given the state of euro markets as well as India's own state of economy, the rates may not be too fine in case one adds the cost of rupee depreciation to the credit risk premium. Here, evidently, RBI cannot make a difference through intervention.



The extraneous condition is the dollar-euro relationship. When the Greek debt was swapped, it was felt that a solution was found. But, there are good chances that Greece will renege on its side of the deal of following austerity. The dollar will hence continue to strengthen as long as the euro region is fragile. Greece will remain in suspension till the June elections, and if it goes down and out of the euro, contagion will spread to Spain, Portugal and maybe even Italy. All this means the dollar will become stronger and the rupee will take a beating again. Will RBI intervention work here? The answer again is no.

Either which way, RBI cannot really combat such adversity and it makes sense to let things be. Will this be the end for us? The answer is no. While the panic is palpable currently with cries for intervention, there is an obvious solution that has been missed here. All the affected parties should be using the F&O route and hedge their risks. The forex derivative market is well developed and surprisingly all through the crises months last year as well as this year, the overall traded volumes have remained largely stable and not increased. Why aren't corporates hedging? Our imports could be $600 billion this year, which should ideally be hedged. Hedging is insurance for price risk, and the price here is the exchange rate. Simply put, when we see the rupee depreciate, one should go long and buy forward, so that when it does depreciate, there is cover. Similarly we have debt servicing to be honoured during the year, which should be hedged. And since there are 'options' available now on the forex currency exchanges, the actual cost is only the option premium.

MADAN SABNAVIS

Corporates are already in the habit of hedging their raw material risks either through global futures in case of crude (NYMEX or ICE) and metals (LME) or through bilateral agreements with vendors domestically. Forex is one commodity that is generally not touched on the premise that the rupee will never really go very down and that the central bank is there to lend a helping hand. It did do so last year by pushing in over $20 billion to stabilise the rupee. This didn't happen again.

The issue is that once players know that RBI will intervene, the speculative elements come in and start guessing the moves. While RBI has put curbs on exporters by ensuring that dollars in the EEFC accounts come in, importers could rush in to buy dollars or plain speculators could start punting in the market. This makes the system even more volatile and unstable as one cannot separate these elements.

Markets always self-correct in the absence of intervention as more expensive dollars make imports dearer and exports competitive, which should help in bringing equilibrium. Inflation will certainly be there, but then we cannot expect some authority to intervene for each element of inflation when there are demand-supply mismatches. For the theoretically inclined, even the REER (real effective exchange rate) is at a low, which should get reflected in the nominal rate (which it does). We should certainly not hold on to an unrealistic rate merely because we are used to a dollar coming for less than a certain targeted rate.

The author is Chief Economist, CARE Ratings. These are his personal views

Bitter medicine

Standing Committee report is a wake-up call for the safety of patients and credibility of India's pharma industry

The 59th report of the department-related Parliamentary Standing Committee (PSC-59) on Health & Family Welfare, on the functioning of the Central Drugs Standard Control Organisation (CDSCO), has created a huge impact in the country. This report was presented in the Rajya Sabha on May 8, 2012, and all hell has broken loose since then.

PSC-59 is in 18 paras, very well documented and easy even for the lay person to get an overall idea of the perspective and context in which the report has been prepared. The focus of the report is on the functioning of the office of the Drugs Controller General of India. This organisation operates under the ministry of health and family welfare and is the apex regulatory authority in India which has to ensure that all medicines or medical devices made or sold in the country are safe, efficacious and are of good quality. The responsibility is immense and all developed economies like the US, the UK, EU and Japan have such organisations to regulate the pharmaceutical industry, clinical trials, etc.

How far has India reached in setting up a world-class CDSCO? I think we have a long way to go, though in the last five years a lot has been done. CDSCO is under-funded and under-staffed, as PSC-59 reveals. Since India has a federal structure, the states also have their own state food and drugs authority (FDA) which under the delegated responsibilities mentioned in the Drugs and Cosmetics Act functions in the respective states. The state FDAs are also woefully under-staffed and under-funded.

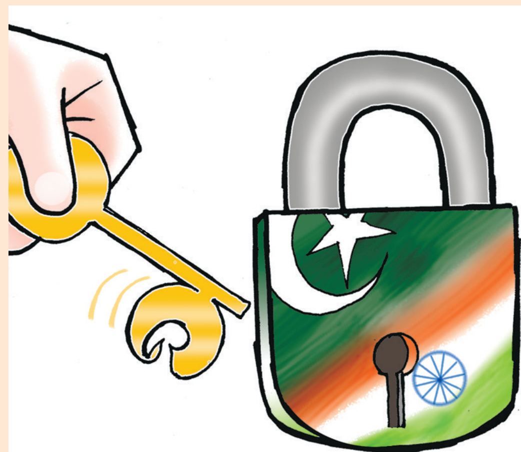
The health ministry has opined that there is a need for approximately 1,375 persons to man various posts in the CDSCO central office and at the various zonal offices in the country, including sites at seaports and airports. The current staff strength is only 124! It is impossible for CDSCO to carry out its obligations in these circumstances.

All the states put together require a total of 3,200 drug inspectors (DIs). There are only 846 DIs in place all over India. These DIs are required to oversee 10,500 manufacturing sites and over 6 lakh retail sales outlets!

The most damaging and controversial part of PSC-59 is the charge that there exists an unholy nexus between drug companies, doctors and CDSCO. This has created a great deal of heated debate and consternation.

As many as 33 cases have been cited where CDSCO has granted permission for the introduction of new drugs without conducting phase-3 trials on a cross-section of the Indian population. Recommendatory letters from the respective medical experts in various hospitals suggesting waiver of phase-3 trials have been given in PSC-59 showing identical language and so on. A conclusion has been reached in PSC-59 that the 'invisible hand' of drug companies can be seen in all of this.

If the waiver of phase-3 trials has been recommended by the doctors and accepted by CDSCO without proper application of mind, then certainly the matter is serious. It will be necessary for a new set of medical experts to look into these allegations and reach a conclusion, viz even if the letters are identical and have been prepared by drug companies to be 'blindly' signed by the concerned doctors, is the advice for waiving of phase-3 trials right or wrong? To be fair, the public at large would also like to know how many phase-3 trials have been conducted in India for new drugs in the past, say, last 10 years, where the phase-3 trials have revealed that the genetic/ethnic background of diverse Indian patients from different parts of the country have shown significant differences in drug uptake in blood or have shown adverse reactions. This will reveal the extent of risk involved when releasing a new drug into the Indian market without phase-3 trials.


RAMESH ADIGE

PSC-59 also brings to the fore the minimum educational qualifications that a person must have to be employed in CDSCO at various levels and also at the state level.

The report runs into some 118 pages and can be seen on the Rajya Sabha website. It has been prepared after multiple interactions of PSC with the health ministry and after going through voluminous replies given by the health ministry in response to the questions asked by PSC. It will be useful for interested persons in the medical field to also see the complete inputs that the health ministry has given to PSC, by getting it uploaded on the Rajya Sabha website. In today's digital age, this can easily be done.

The health ministry has correctly and promptly responded by appointing a highly-competent three-member committee consisting of Dr VM Katoch, secretary, health research; Dr PN Tandon, chairman, National Brain Research Institute; and Dr SS Aggarwal, ex-director, Sanjay Gandhi PG Institute, to go into PSC-59 in order to take corrective action and preventive action, wherever required. This should be out in two months' time.

Meanwhile, PSC-59 is a clarion call for everybody involved in the area of healthcare to keep ethical behaviour topmost in all their activities and publicly state or restate this intention. This would include the Medical Council of India, the different pharmaceutical associations on behalf of their constituents, and CDSCO/FDAs. I have no doubt that all would rise to the occasion. CDSCO can also make a quick beginning by correcting its Mission Statement to reflect its obligations towards public health and safety.

The Indian pharmaceutical industry and the Indian healthcare industry are sunrise sectors and all care must be taken to preserve credibility both in India and the global sphere. Full credit to PSC for bringing up these issues, which merit immediate attention. A note of caution though, let us not tar reputations before the three-member committee submits its findings.

The author retired as president of Ranbaxy Laboratories

EAVESDROPPER

ROHNIT PHORE

We're called Reliance!

At the launch of Ejaz Ghani's book, *Reshaping Tomorrow: What will India look like in 2025?*, at Ficci on Monday, Congress General Secretary Digvijay Singh recounted an anecdote about a meeting he had with the late Dhirubhai Ambani. Ambani, Singh recalled, said if the government left things to him, he would find a solution to the Indo-Pak problem as well! Given the proximity of Reliance's refinery to the border, Reliance has always promoted an active dialogue between the two countries and its Observer Research Foundation has been associated with many track-II diplomatic moves.

Agatha Christie

Former Lok Sabha Speaker PA Sangma's name is making the rounds as a prospective candidate in the upcoming presidential polls. What endears him most to senior BJP leader LK Advani, however, is not his political credentials for the job, but the fact that Sangma's two daughters are named Agatha and Christie. Obviously, someone in the family is a huge mystery buff, a fact that Advani apparently appreciates in a candidate.

What Swiss association?

The biggest deposit-holders in Swiss banks are Indians. For years, that's been received wisdom though few know the origins of the belief. The government's white paper on black money traces that to a chain mail from the "Swiss Banking Association" report of 2006, but points out there is no such organisation. Data from the Swiss National Bank, cited in the white paper, shows Indian depositors account for just 0.13% of all deposits in Swiss banks, and this number has been falling over a period of time.

Retrospective support

While many have expressed their dismay over India's retrospective taxation measures, the government's white paper points to some retrospective support for what India's doing. Though many countries have signed agreements with the Swiss to share information on information, the government's white paper on black money points out that India is the only country with which Switzerland has agreed to share the information on a retrospective basis—the period of retrospectivity, though, is quite limited.

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