Highlights of Economic Survey

2016-17

PRESS RELEASE
FICCI comments on Economic Survey 2016-17

New Delhi, 31 January 2017: Commenting on the Economic Survey 2016-17 tabled in the Parliament today, **Mr. Pankaj Patel, President, FICCI** said "*The survey clearly lays out the challenges and opportunities that India faces at the present juncture. FICCI agrees with the need to overcome the three 'meta challenges' as identified in the survey namely inefficient redistribution, ambivalence about the private sector and property rights and the improving but still challenged state capacity. A clear plan of action with sustained reforms in each of these areas by the government is a must to attain sustained high and inclusive growth."*

"The growth projected for the current year is lower by quarter to half a percentage point compared to the baseline of 7 per cent. The downward pressure is on account of demonetisation, but the survey adds that the contractionary effects will dissipate by the end of the year and we could see a better performance in FY18. Even with this performance, India will continue to be the fastest growing major economy in the world", added **Mr. Patel**.

"*As pointed out by the Economic Survey and emphasised by FICCI, in order to reap the long term benefits of demonetisation there is a need to have follow up actions such as providing a boost to demand, lowering of tax rates, widening of the tax base and reforming the tax administration. FICCI hopes that the Union Budget to be presented tomorrow will include measures in these areas*", said **Mr. Patel**.

"*Taking account of the current global and domestic economic situation, the Economic Survey stresses the importance to re-establish private investment and exports as the major drivers of growth. FICCI's most recent Business Confidence Survey and Economic Outlook Survey clearly point in this direction and we will be looking for signals in the budget to give a boost to these areas*", added **Mr. Patel**.

Further, in context of the twin balance sheet problem, the Economic Survey has mooted the idea of having a centralised public sector asset rehabilitation agency (PARA). FICCI welcomes this suggestion and it is closely related to 0ur earlier submission to have a National Asset Management Company (NAMCO) to address the issue of large and complex stressed assets particularly in the infrastructure sector. Such an institution, in our view, should be professionally managed, majority funded by the private sector with institutional backing of the government.

FICCI has also noted the survey's suggestion on the need to have detailed discussions on the concept of Universal Basic Income which could help improve the inclusion aspect of our growth. This is an extension of the idea that was mooted by the government earlier when it introduced the concept of JAM trinity and is currently implementing the same with full vigour.

FICCI would like to mention that alongside social security, there must be an equal emphasis on creation of jobs in the economy and all our public policies must be geared towards this objective.

"*Finally, as the Survey mentions, we are witnessing a new economic order globally with shift once again leaning towards protectionism following the BREXIT and America First policy of the new administration in US. FICCI is of the view that in this backdrop there is a need to set up an industry - government taskforce to address the current developments and their consequences for Indian industry and business*", said **Mr. Patel.**

Economic Survey 2016-17

Economic Outlook

- ***GDP growth for the year 2017-18 forecasted between 6.75%-7.5%.*** The Survey cited that the new currency notes are slowly coming back in circulation and the follow up actions on various steps taken post demonetization are also underway – this is expected to support growth in 2017-18. Earlier in January 2017, CSO had put a growth estimate of 7.1% for 2016-17. This was an extrapolated number based on the information available for the first seven to eight months of the financial year.

Upsides for 2017-18

- India's exports are recovering
- Consumption expected to pick up as effect of demonetization wanes off and on account of lower borrowing costs –spending on housing and consumer durables to increase

Downsides for 2017-18

- With problem of twin balance sheet persisting, private investments unlikely to pick up. Both investment rate and saving rate have come down and will have to be raised
- Any delay in implementation of policy response to demonetization
- Crude prices
- Possible eruption of trade tensions

- Implementation of Goods and Services Tax and De-monetization have been the two big announcements in 2016. According to the Survey ***follow up actions to minimize the costs and maximise the benefits will give an impetus to growth in 2017-18***. These actions include - fast, demand-driven, remonetisation; further tax reforms, including bringing land and real estate into the GST, reducing tax rates and stamp duties; and acting to allay anxieties about over-zealous tax administration.

- Need for societal shifts in ideas to ***overcome three 'long-standing meta-challenges'***

  - ***Inefficient redistribution*** - redistribution by Government in terms of targeting the poor remains inefficient
  - ***Ambivalence about the private sector and property rights*** - difficulties witnessed in advancing strategic disinvestments, persistence of twin balance sheet problem, protection of intellectual property rights
  - ***Improving but still-challenged state capacity*** - delivery of essential services remains impaired

Three key external sector developments to look out for

- Changing outlook for global interest rates; particularly in light of the US elections
- With some recent development, the political outlook for globalisation is undergoing a change
- Developments in the US, especially the rise of the dollar, will have implications for China's currency and currency policy

Prices

- Consumer price inflation has been range bound so far in the year 2016. However some pressure was seen emerging with global commodity prices edging up.

- According to the Survey, with the deceleration in wholesale and retail prices of key food items during the second half of 2016-17, the average inflation based on CPI is expected to remain below 5 per cent. However, CPI based core inflation has remained sticky so far during the current fiscal year.

- For the year 2017-18, the uptick in global commodity prices particularly crude oil prices pose as a risk factor. Food inflation is likely to remain subdued in the light of higher Rabi sowing acreage, projected increase in the production of pulses and key agri-products globally, astute food management by the Government and price monitoring.

Fiscal Outlook

- India has remained committed to fiscal consolidation which is reflected in the steady decline in fiscal deficit over the past three years. The fiscal deficit to GDP ratio target for 2016-17 was projected at 3.5%. The target most likely will be met.

- The survey indicated the following three factors that will impact fiscal outlook in 2017-18:

  - Fiscal windfall both from the high denomination notes that are not returned to the RBI and from higher tax collections as a result of increased disclosure under the Pradhan Mantra Garib Kalyan Yojana (PMGKY)

  - Implementation of the GST. Government has commitment to compensate the states for any shortfall in their own GST collections, the outlook is cautious with respect to revenue collections. Full gains of the GST will take time to realize

  - There has been an increase in the tax to GDP ratio by about 0.5 percentage points in each of the last two years, owing to the oil windfall. This is likely to wane off. In fact, excise-related taxes are expected to decline by about 0.1 percentage point of GDP, after a swing of about 0.6 percentage points relative to 2016-17.

- India is on a convergence path and the country is expected to witness significant growth rates for next two decades. Debt dynamics, therefore, for the next decade will be favourable for India as compared to most advanced countries and emerging market economies.

- On the deficit front, India's high primary deficit is of grave concern which can expose the country to high levels of debt ratio if growth and interest rate differential falters. India's experience has highlighted the risk of relying on rapid growth rather than steady primary balance adjustment to reduce debt. The approach has failed to put the debt-GDP ratio firmly on a downward path. The new FRBM Committee formed by the government is reviewing the flow and stock vulnerabilities prevailing in the country and set out a new vision, an FRBM for the 21st century.

- As far as States are concerned, most of them have displayed an impressive performance in containing the fiscal deficit to 3% of GSDP. Apart from the Fiscal Responsibility Legislation (FRL), which made an impact in terms of outcomes as well as behavior, much of the improvement in fiscal management came from increased transfers from the centre, decline in interest payments, higher GDP growth in states and increased expenditure by the centre towards Centrally Sponsored Schemes.

- The restraint in spending displayed by States is praiseworthy. However, with fiscal challenges rising on account of higher pay outs as recommended in the seventh pay commission, slowing growth and rising payments from UDAY bonds, conditions will not be as smooth as they were in the mid-2000s.

External Sector

- India's exports have noted an uptick in the year 2016-17, after reporting deceleration for two consecutive years. Our exports to some major destinations like United States, Europe and Asia have noted an increase.

- Trade deficit declined to US$ 76.5 billion in 2016-17 (April-December) as compared to US$ 100.1 billion in the corresponding period of the previous year.

- The current account deficit (CAD) remains range bound and narrowed in the first half (H1) of 2016-17 to 0.3 per cent of GDP from 1.5 per cent in H1 of 2015-16 and 1.1 per cent in 2015-16 full year.

- The Survey states that given that India's growth ambitions of 8-10 percent require export growth of about 15-20 percent, any serious retreat from openness on the part of India's trading partners would jeopardize those ambitions.

- On the trade front the Survey identifies the opportunities that can arise for India on back of the changing global trade scenario. It is suggested that in order to promote labour-intensive exports, India could more proactively seek to negotiate free trade agreements with the UK and Europe. Further, given the geo political shift and United States receding from major trade agreements, India should proactively pursue reviving the WTO and multilateralism more broadly.

Potential additional exports and jobs of FTAs with EU and UK FTA

	Apparels		Leather Goods		Footwear	
	Incremental Exports ($Mn)	Gain in Employment (number)	Incremental Exports ($Mn)	Gain in Employment (number)	Incremental Exports ($Mn)	Gain in Employment (number)
EU	1483.6	76853	416.9	18542	216.9	9966
UK	603.3	31176	103.8	4615	95.3	4381
Total	2086.9	108029	520.7	23156	312.2	14347

Demonetisation: To Deify or Demonize?

- The Economic Survey states that Demonetisation has been a radical, unprecedented step with short term costs and long term benefits. The liquidity squeeze was less severe than suggested by the headlines and has been easing since end-December 2016.

- The impact of demonetisation in the Economic Survey is based on a macro-assessment, specifically on five broad indicators namely: Agricultural (rabi) sowing; Indirect tax revenue, as a broad gauge of production and sales; Auto sales generally, as a measure of discretionary consumer spending, and two-wheelers (an indicator of rural and demand of the less affluent); Real estate prices; and Real Credit growth.
    - Agricultural sowing, passenger car sales, and overall excise taxes bear little imprint of demonetisation
    - Sales of two-wheelers show a marked decline after demonetisation; credit numbers were already looking weak before demonetisation, and those pre-existing trends were further reinforced after November 8.

- Based on this macro-assessment, the Economic Survey states that demonetisation will have implications for GDP, reducing 2016-17 growth by ¼ to ½ percentage points compared to the baseline of 7 percent. It further adds that recorded GDP growth in the second half of FY2017 will understate the overall impact because the most affected parts of the economy — informal and cash based — are either not captured in the national income accounts or to the extent they are, their measurement is based on formal sector indicators (for example, informal manufacturing is estimated using formal sector indicators (Index of Industrial Production). Also, these contractionary effects will dissipate by year-end when currency in circulation should once again be in line with estimated demand, which would also allow growth to converge to a trend by FY 2017-18.

- As per the Economic Survey, demonetisation will affect the fiscal accounts in the following ways:
    - Wealth gain to RBI/ Government from unreturned cash
    - Short-term flow impact: While income taxes could go up, the negative effect will be from cost of printing new notes, cost of sterilizing the surge in liquidity into the banking system via MSS bonds, and reduction in corporate and indirect tax revenues if nominal GDP growth declines.

- The short and long term impact of demonetisation is encapsulated in the table below

Sector	Short term impact (end of December)	Long run impact
Money/ Interest rates	• Cash declined and bank deposits increased • RBI's balance sheet remained largely unaffected • Interest rates on deposits, loans, and government securities declined; implicit rate on cash increased	• Cash will recover. Deposits will decline • RBI's balance sheet will shrink after the deadline for note exchange • Loan rates could fall further, if much of the deposit increase proves durable
Financial system savings	• Increased	• Increased
Unaccounted income/ black money	• Reduced to some extent	• Formalization should reduce the flow of unaccounted income
Private wealth	• Declined since some high denomination notes were not returned and real estate price fell	• If the real estate prices continue to decline, wealth may decline further
Public sector wealth	• Unaffected	• Government's and RBI's income may increase if some of the banned notes are not returned
Digitization	• Increase in the number of AEPS and RuPay users • Increase in the number of transactions by existing users	• While some may return to cash transaction, the digital revolution will remain strong
Real estate	• Prices declined and wealth fell	• Prices could fall further as investing undeclared income in real estate becomes more difficult • Tax component could rise especially with GST
Economy	• Job losses • Decline in farm income • Social disruption in cash-intensive sectors	• Gradual stabilization expected
GDP	• Growth slowed • Cash intensive sectors affected more	• Increase in formalization could be beneficial to the GDP • Informal output could decline but with formalization recorded GDP would increase
Tax collection	• Rise in income tax collected • Payments to local bodies and discoms increased	• Indirect and corporate taxes could decline due to slow growth • Over long run, taxes should increase as formalization expands and compliance improves
Uncertainty/ credibility of the economic	• Increase in uncertainty	• Credibility will be strengthened if the move

climate	• Investment decision and durable goods purchase postponed	is accompanies by complementary measures • Early and full remonetisation essential • Tax arbitrariness and harassment could weaken credibility

The future markers of success for demonetization are as follows

a. Changes are expected in the use of digital payment methods across the three categories of digital access, namely, smart phone users, regular phone users and the phoneless, respectively
b. The cash-GDP ratio should decline as more saving is channeled through the formal financial system and black money falls
c. The number of new income tax payers as well as the magnitude of reported and taxable income should go up over time.
d. Expected increase in registration under the service and excise taxes and under the states' VATs as the move has raised the cost of non-compliance with indirect taxes.

Measures suggested to maximize the benefit from demonetization:

Short term measures:

a. The cash shortage should be replenished as quickly as possible. The faster remonetisation takes place, the shorter and less severe will be the overall impact of demonetisation.
b. Internal convertibility of asset is important. Unless people have confidence that money deposited in bank accounts is freely convertible into cash, and vice versa, they will be reluctant to deposit their cash in the first place. RBI should re-establish internal convertibility by guaranteeing to give the public the amount of currency that the latter wants. The early elimination of withdrawal limits will help build confidence.
c. There should be no penalties on cash withdrawals, which would only encourage cash hoarding.
d. The government windfall arising from unreturned notes should be deployed toward capital-type expenditures rather than current ones.
e. In the medium term, the impetus provided to digitization must continue.
f. Digitization must be incentivized. The cost must be borne by the public sector (government/RBI) and not the consumer or financial intermediaries. Incentivisation should be strictly time-bound.
g. Cybersecurity systems must be strengthened considerably.
h. Inter-operability of the payment system is important.

Long term measures:

a. GST with broad coverage to include activities that are sources of black money creation—land and other immovable property—should be implemented.
b. Individual income tax rates and real estate stamp duties could be reduced.
c. The income tax net could be widened gradually and, consistent with constitutional arrangements, could progressively encompass all high incomes.
d. The timetable for reducing the corporate tax rate could be accelerated.
e. Tax administration could be improved to reduce discretion and improve accountability.

The Festering Twin Balance Sheet Problem

- The Economic Survey notes that India has been trying to solve its Twin Balance Sheet problem–overleveraged companies and bad-loan-encumbered banks but the problem has continued to fester: NPAs keep growing, while credit and investment keep falling. It adds that perhaps it is time to consider a different approach – a centralised

Public Sector Asset Rehabilitation Agency (PARA) that could take charge of the largest, most difficult cases, and make politically tough decisions to reduce debt.

- The Economic Survey presents the broad outline of how a PARA would work.
    - It would purchase specified loans (for example, those belonging to large, over-indebted infrastructure and steel firms) from banks and then work them out, either by converting debt to equity and selling the stakes in auctions or by granting debt reduction, depending on professional assessments of the value-maximizing strategy.
    - Once the loans are off the books of the public sector banks, the government would recapitalise them, thereby restoring them to financial health and allowing them to shift their resources – financial and human –back toward the critical task of making new loans. Similarly, once the financial viability of the over-indebted enterprises is restored, they will be able to focus on their operations, rather than their finances. And they will finally be able to consider new investments.
    - The capital requirements would be large. The funding would partly need to come from government issues of securities. A second source of funding could be the capital markets, if the PARA were to be structured in a way that would encourage the private sector to take up an equity share. A third source of capital could be the RBI. The RBI would (in effect) transfer some of the government securities it is currently holding to public sector banks and PARA. As a result, the RBI's capital would decrease, while that of the banks and PARA would increase. There would be no implications for monetary policy, since no new money would be created.

Universal Basic Income

- UBI has been recommended as an alternative to the various social welfare schemes which could reduce poverty. The proposed concept of UBI will have three components: universality, unconditionality and agency. It is perceived as a 'right' given to every individual or citizen of India whereby he/she will have access to an income to cover basic needs.

- UBI could have several benefits: can help create a just and non-exploitative society, promote greater productivity, reduce poverty; enhance the status of an individual (poor) from a subject to an 'agent', empowering them to take their own economic decisions, increase bargaining power of individuals in the labour market.

- UBI can also help in overcoming the weaknesses present in the existing welfare schemes, and can help in overcoming the issues related to misallocation as it will involve only a transfer of resources wherein beneficiaries will not necessarily be required to 'access' the resource. The simplicity of the concept would also make it easier to administer and monitor the scheme. The scheme will be universal and hence it would lead to lower exclusion errors.

- The survey further advocates that, since UBI is a cash transfer, its real value will be determined by inflation and hence it should be indexed to prices to ensure revision of the amount periodically.

- For successful implementation of UBI, it would be essential that the JAM system functions well and the issue of cost sharing between centre and state is resolved.

- The survey also cautions that though it is an appealing idea, implementation of the scheme may create certain challenges particular the fact that it could become an additional programme, and not a replacement of the current social programmes. This could make the scheme financially unviable.

One Economic India - Integrated India

- Contrary to the general perception, an analysis of information from Big Data - invoice level transactions from the GSTN shows that India is highly integrated internally, with considerable flows of both people and goods.

- According to the results presented in the Economic Survey 2016-17, estimates for interstate trade flows indicate that cross-border exchanges between and within firms amount to at least 54 per cent of GDP, implying that interstate trade is 1.7 times larger than international trade.

Country	Year	Interstate/GDP	International/GDP	Ratio of Interstate to International
Brazil[e]	1999	76%	14%	5.4
USA[a]	2015	78%	31%	2.5
India (C+F form)	2015	54%	32%	1.7
India (C form)	2015	32%	32%	1
China[d]	2009	74%	45%	1.6
Canada[b]	2012	20%	62%	0.3
European Union[c]	2015	20%	84%	0.2
Indonesia[f]	2005	12%	63%	0.2

- Though for India the interstate trade (54 per cent of GDP) is not as high as United States or China but substantially greater than provincial trade within Canada and greater than trade between Europe Union

- Further, the data covered mainly included manufactured goods and excludes agricultural products, and is therefore an underestimate of total internal trade in goods

- Further with regard to trade, smaller states like Uttarakhand, Himachal Pradesh and Goa have a higher ratio of trade as a per cent of GSDP; the net exporters are the manufacturing powerhouses of Tamil Nadu and Gujarat. Also, agriculturally rich states like Haryana and Uttar Pradesh also have a strong manufacturing base because of Gurugram and Noida.

Income, Health and Fertility: Convergence Puzzles

- The Economic Survey points out that though India's economic performance has been very good over the past two decades till 2014; there has been diversity in the performance of the states.

- Between 1983 and 2014, all states have shown improvements in their real per capita GSDP. However, in terms of convergence in real per capita GDP during 2004-2014, incomes level in different states of India has diverged. Similar divergence was also observed when convergence in real per capita consumption for states in India was studied.

- This indicates that though states have shown rapid growth over the years, regional inequality among them has also increased.

- The Economic Survey mentions this phenomenon to be confusing because the period between 2004 and 2014 was marked with favourable forces of equalisation including strong and rising movements of goods and people across the sates, which was not the case in the decade previous to that (1994-2004) in which incomes had diverged.

- One possible reason highlighted by the Economic Survey for this regional dispersion in income and consumption is the possibility of some governance traps which could have been there, impeding the growth of some of the states. But the reason for the existence of any such trap has remained unknown.

India on the Move and Churning: New Evidence

The Economic Survey states that the new estimates of labour migration in India have revealed that inter-state labor mobility is significantly higher than previous estimates.

- As per the new study, annually inter-state labour mobility averaged 5-6 million people between 2001 and 2011, yielding an inter-state migrant population of about 60 million and an inter-district migration as high as 80 million. This is significantly greater than the annual average flow of about 4 million suggested by successive Censuses.

- Less affluent states see more out migration migrating out while the most affluent states are the largest recipients of migrants.

- Migration for work and education is accelerating. In the period 2001-2011 the rate of growth of labour migrants nearly doubled relative to the previous decade, rising to 4.5 per cent per annum. Interestingly, the acceleration of migration was particularly pronounced for females and increased at nearly twice the rate of male migration in the 2000s.

- In India, while internal political borders impede the flow of people, language does not seem to be a demonstrable barrier to the flow of people. When similar analyses are done internationally there is a strong language effect, namely that countries with a common language see larger migrant flows. In trade, the common language effect is estimated to be about 16 to 30 per cent more than countries that do not. But within India, in both trade and labour flows, language doesn't seem to matter.

The Economic Survey suggests policy actions to sustain and maximize the benefits of migration namely: ensuring portability of food security benefits, providing healthcare and a basic social security framework for migrants – potentially through an inter-state self-registration process. While there do currently exist multiple schemes that have to do with migrant welfare, they are implemented at the state level, and hence require greater inter-state coordination.

From Competitive Federalism to Competitive Sub-Federalism: Cities as Dynamos

- Urban Indians now form about one-third of the population – and they produce more than three-fifths of the country's GDP. By all accounts, urbanisation will define the trajectory of Indian development.

- India's urbanisation rate appears to have been similar to that in other countries. India's urbanisation rate should begin to converge with those in similar emerging markets, rising to 40 per cent by 2030. And much of this urban growth is likely to take place in the bigger cities.

- India's large cities are unusually small. The reasons could be infrastructure is overburdened and India is land-scarce relative to most countries. By 2050, its land-to-population ratio will have declined fourfold relative to 1960, and India will be amongst the most land-scarce countries in the world.

- Urban local bodies (ULBs) face major and inextricably linked problems: poor governance capacities, large infrastructure deficits and inadequate finances.

- Urbanisation will pose considerable challenges for municipalities over the coming decades. But these challenges can be overcome.

- The first task is empowering ULBs financially. States should empower cities to levy all feasible taxes. The Government should leverage the Indian Space Research Organization (ISRO)/National Remote Sensing Agency (NRSA) to assist ULBs in implementing GIS mapping of all properties in the area of a ULB.

- ULBs need to be empowered but the political economy challenges—higher level bodies (state governments) needing to cede power and sharing resources--are daunting.

- Data and transparency can play an important role.

- Competition between states is becoming a powerful dynamic of change and progress, and that dynamic must extend to competition between states and cities and between cities. Cities that are entrusted with responsibilities, empowered with resources, and encumbered by accountability can become effective vehicles for competitive federalism and, indeed, competitive sub-federalism to be unleashed.

Clothes and Shoes: Can India Reclaim Low Skill Manufacturing?

- The Economic Survey provides that Apparel and Leather & Footwear sectors provide immense opportunities for creation of jobs for the weaker sections, especially for women, and can become vehicles for broader social transformation in the country.

- India has an excellent opportunity to promote apparel, leather and footwear sectors because of rising wage levels in China that has resulted in China stabilizing or losing market share in these products.

- The key challenges which are impediment for the growth of apparel & leather industry have been identified in the areas of logistics, labour regulations, tax & tariff policy, and disadvantages emanating from the international trading environment compared to competitor countries.

- Three key policy responses are suggested to address the twin issues of jobs and promoting exports in these sectors:
  a) signing FTAs especially with EU & UK
  b) GST-induced tax rationalization
  c) labour law reforms