Economy Watch

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State of the Economy

The year 2016 will be marked as a watershed year in the history of both global as well as Indian economy. It has been a year of many resets and has been unprecedented in several ways. In fact, since our last Economy Watch edition, several new challenges have surfaced which will set the stage for 2017.

While the announcement of the Brexit referendum dominated the news in the first quarter of the fiscal year 2016-17, the initiation of talks in September to cut crude production targets sent the oil market in to a tizzy. OPEC's final decision to cut production by 1.2 million barrels per day on November 30, 2016 caused the Brent oil prices to spike immediately.

In fact, November has been a rather eventful month. The result of the US elections was announced on November 8, 2016 and Mr Donald Trump, President-elect will assume office on January 20, 2017. This has brought to fore some anxieties. The anxiety stems from the policy direction that will be undertaken by the United States in the months to come. The initial direction signals towards inward looking and protectionist tendencies. Further, the Federal Reserve's decision to increase the interest rates in December policy meeting was widely anticipated; however, it did lead to volatility in the emerging economies currency markets.

The domestic front has also been action-packed with the Government announcing demonetization of high value currency notes in November 2016. The decision came with a sudden bang and is certainly a bold one. The anticipated gains from this move will be huge in the long run and will more than compensate for the passing discomfort.

Gross Domestic Product

GDP numbers reported a growth of 7.2% in the first half of fiscal year 2016-17. GDP growth was reported at 7.1% in Q1, which marginally improved to 7.3% in Q2. The latest advance estimates released by the Government on January 6, 2017 indicate a GDP growth of 7.1% for 2016-17 (this is lower than 7.6% growth reported in 2015-16). Given that the growth in the second half of the fiscal year is likely to average about 7.0%.

The assessment from the expenditure side points towards an expected moderation in private final consumption expenditure and subdued capital formation. Gross capital formation is estimated to contract by 1.4% in 2016-17. Nonetheless, government final consumption expenditure is forecasted to record a robust double digit growth of 23.8% in 2016-17, vis-à-vis 2.2% growth recorded in 2015-16.

Table 1: GDP Growth: Expenditure side (in %)

	GDP	Private Final Consumption Expenditure	Government Final Consumption Expenditure	Gross Capital Formation
2015-16	7.6	7.5	2.2	3.4
2016-17	7.1	6.5	23.8	-1.4
Q1 2016-17	7.1	6.7	18.8	-4.6
Q2 2016-17	7.3	7.6	15.3	-6.8

Source: CMIE

From the economic activity side, GVA is forecasted to grow by 7.0% in the current fiscal year. This is in line with RBI's prognosis of a downward revision in GVA growth (to 7.1%) in the policy announcement in December 2016. As per the latest data released by the Central Statistical Organization, agriculture growth is projected to see an uptick and will largely support growth. Monsoons have been good which has come as a big boon this year. The Rabi acreage up till January 6, 2017 has reported an increase by 6.5% y-o-y. On the other hand, both industry and services sector growth are likely to witness moderation; with the extent of moderation being more distinct in case of the industry sector.

Table 2: GDP Growth: Economic Activity Based (in %)

	GVA at basic prices	Agriculture, forestry and fishing	Industry	Services
2015-16	7.2	1.3	7.4	8.9
2016-17	7.0	4.1	5.2	8.8
Q1 2016-17	7.3	1.8	6.0	9.6
Q2 2016-17	7.1	3.3	5.2	8.9

Source: CMIE

However, it needs to be noted that these estimates do not reflect the impact of demonetization on GDP as the key data is available only till the month of October. There is no precedence to this kind of demonetization and it is difficult to quantify the overall impact on GDP growth. The estimates released have been arrived at through extrapolation.

The currency ban has had an impact on the cash dependent sectors. Retail trade, hospitality, tourism, gems and jewellery sectors have reported a drop in business activity. Even sectors like automobiles and consumer goods have seen a drop in demand especially in rural areas. However, the re-monetization phase is underway and once the currency is back in circulation, GDP growth is expected to recover.

Index of Industrial Production

As per the latest IIP data available, industrial production registered a growth of 5.7% in November 2016 vis-à-vis a contraction of 1.8% noted in October 2016. Manufacturing sector which constitutes about three fourths of industrial production index grew by 5.5% in November 2016 after witnessing a contraction of 2.4% in October 2016. This is in line with the results of FICCI's latest Manufacturing Survey that predicted a better performance for this sector during the period October to December 2016.

As for the performance of the mining and electricity sectors, the two noted a growth of 3.9% and 8.9% respectively.

Table 3: Index of Industrial Production Growth (in %)

% growth rate	Nov-15	Aug-16	Sep-16	Oct-16	Nov-16
IIP	-3.4	-0.7	0.7	-1.8	5.7
Sectoral					
Mining & quarrying	1.7	-5.9	-3.2	-0.7	3.9
Manufacturing	-4.6	-0.3	0.9	-2.4	5.5
Electricity	0.8	0.1	2.4	1.1	8.9
Use-base industry classification					
Basic goods	-0.5	3.5	3.9	4.2	4.7
Capital goods	-24.4	-22.4	-21.6	-26.9	15.0
Intermediate goods	-1.5	3.3	2.1	2.7	2.7
Consumer durables	12.2	2.1	13.9	0.6	9.8
Consumer non-durables	-4.9	-0.5	0.1	-2.9	2.9

Source: CMIE

As per the used based classification of industrial production, the performance of the capital goods has also noted a marked improvement. The sector has been in the contractionary zone for twelve consecutive months now with growth falling by 26.9% in October 2016. However, in November 2016, growth was in the positive terrain and the sector grew by 15.0%. Growth in consumer durables was seen at 9.8% in November 2016 as compared to 0.6% growth noticed in the previous month. Consumer non-durables grew by 2.9% in November 2016 as against a negative growth of 2.9% in the previous month.

A cut in the repo rate by the Reserve Bank of India in the December policy meeting was being widely anticipated and could have boded well for the industry and the consumers. Nonetheless, some banks finally made the move on January 1, 2017 by revising down their lending rates. Both consumption and investment demand are expected to benefit from this lowering of rates.

Table 4: One Year MCLR of Banks

Bank	New rate	Old rate
SBI	8.00%	8.90%
PNB	8.45%	9.15%
Union Bank of India	8.65%	9.30%
IDBI	9.15%	9.30%
SBT	9.20%	9.45%
Syndicate Bank	8.75%	9.45%
Indian Bank	8.60%	9.35%
Oriental bank of Commerce	8.60%	9.40%
Andhra Bank	8.45%	9.25%
Dena Bank	8.55%	9.30%
ICICI	8.20%	8.90%

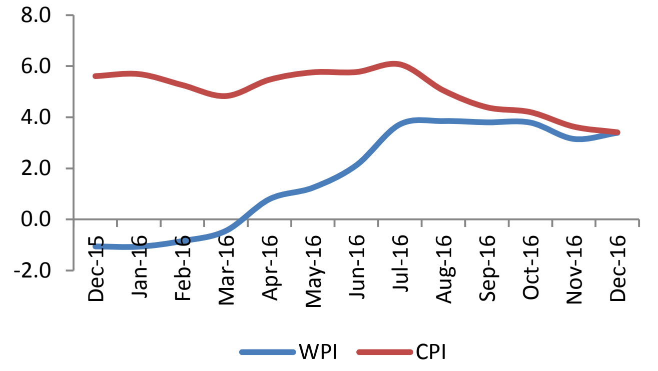
Source: Various Press Articles

Inflation

Both wholesale and consumer price index indicate a continuation of moderate phase in the inflation rate. The wholesale price index based inflation rate inched up to 3.4% in the month of December 2016 (vis-à-vis 3.2% in November 2016). Retail prices were seen moderating during the month with inflation rate easing to 3.4% (vis-à-vis 3.6% in November 2016).

The easing food prices remained the key factor behind the moderate inflationary pressures.

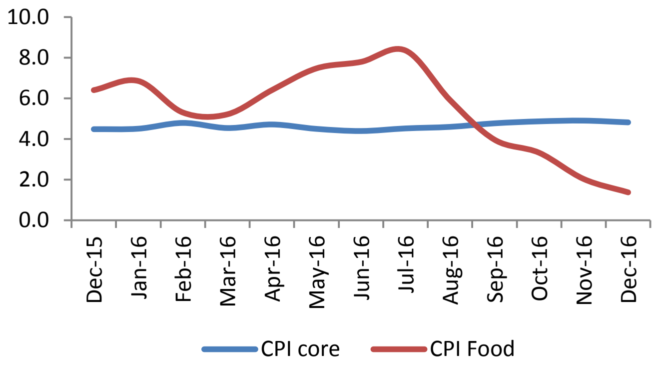
Chart 1: Inflation Rate (in %)



Source: CMIE

WPI based food inflation was reported at a fifteen month low of (-) 0.7% in December 2016. And CPI based food inflation stood at 1.4% in the same month as compared to 2.0% inflation rate reported in November 2016. Within the food segment, an evident decline was noticed in fruits & vegetables prices. Prices of pulses also noted moderation.

Chart 2: CPI Core and CPI Food Inflation rate (in %)



Source: CMIE & FICCI Research

Good monsoons and constant monitoring of prices accompanied with timely control measures taken by the government have kept the inflation range bound. The Reserve Bank in its December policy assessment has maintained the CPI projection at 5% for Q4 2016-17. However, the bank does point towards upside risks emerging from imposition of oil production quotas by OECD, increase in commodity prices and pressures arising from volatility in exchange rates.

Nonetheless, as per FICCI's latest Economic Outlook Survey, prices are likely to remain benign this year.

The median forecast for Consumer Price Index (CPI) has been put at 5.1% for 2016-17, with a minimum and maximum range of 4.0% and 5.2% respectively.

External Sector

Growth of merchandise exports was reported at 5.7% in December 2016 as compared to a decline of 13.6 percent noted in the same month previous year. In terms of value, exports stood at US$ 23.9 billion in December 2016. Exports noted a marginal uptick on a cumulative basis as well and stood at US$ 198.7 billion during April-December 2016. Both, oil as well as non-oil exports, observed improvement in growth. Some of the key export items such as engineering goods, petroleum products, gems and jewellery and drugs, pharmaceuticals & fine chemicals noted better growth numbers during the month.

Chart 3: Merchandise Trade Growth in %

Month	Exports - Total	Exports - POL	Exports - Non-POL	Imports - Total	Imports - POL	Imports -Non-POL
Dec-15	-13.6	-43.5	-7.4	-3.5	-33.1	8.1
Jan-16	-14.1	-34.5	-11.2	-11.2	-39.0	-1.7
Feb-16	-5.9	-26.7	-3.1	-5.5	-21.9	-1.0
Mar-16	-5.2	-18.0	-3.6	-23.8	-35.3	-20.8
Apr-16	-5.7	-24.2	-3.0	-23.1	-23.7	-22.9
May-16	-0.6	-16.6	1.5	-13.7	-30.0	-7.9
Jun-16	2.0	-10.0	3.8	-7.4	-16.1	-4.4
Jul-16	-7.0	-15.7	-5.6	-18.9	-27.9	-15.7
Aug-16	0.0	-10.6	1.6	-14.2	-8.2	-15.9
Sep-16	4.8	1.1	5.3	-2.5	3.4	-4.1
Oct-16	8.2	11.0	7.8	8.0	4.0	9.1
Nov-16	2.3	3.9	2.1	9.5	5.9	10.5
Dec-16	5.7	8.2	5.4	0.5	14.6	-3.0

Source: CMIE

India's overall imports stood at US$ 34.3 billion in December 2016 which was 0.5% higher than US$ 34.1 billion worth of imports in the corresponding month previous year. Oil imports witnessed a growth of 14.6% while non-oil imports contracted by 3.0% during the month. Trade deficit stood at US$ 10.4 billion in December 2016 (vis-à-vis US$ 11.5 billion in December 2015).

Further, latest data on India's Balance of Payments reports a current account deficit of US$ 3.4 billion in Q2 2016-17 as compared to US$ 8.5 billion deficit reported in the corresponding quarter previous year. Current account deficit stood at 0.6% of GDP in Q2 2016-17 as compared to 1.7% of GDP in Q2 2015-16.

Way Forward

The global conditions are still uncertain and the recovery process will remain long drawn. The way the Brexit negotiations shape up and the policy direction that United States embraces will have an impact on the global economy including India.

Amidst this environment of uncertainty, India should keep the focus on strengthening the domestic economy. The Government should carry forward its reform agenda in the forthcoming Union Budget. In fact, already on the eve of the New Year, Hon'ble Prime Minister has set the tone by announcing measures to support MSMEs, farmers and senior citizens - which is very encouraging.

The budget will also offer the Government a good opportunity to outline steps to strengthen growth in the economy and come out of the negative shock resulting from demonetization. Driving growth and job creation should remain the key priorities. The budget must also include measures to drive consumption.

Expectations from Union Budget 2017-18

The Budget for FY18 would be presented against the backdrop of heightened uncertainty both locally and globally. Although global growth picked up somewhat in the second half of 2016, after weakening in the first half, the global economic landscape has changed considerably through the year in view of events like Brexit, Donald Trump becoming President elect of US and Referendum defeat of Mr Renzi in Italy. These events have created substantial geopolitical uncertainty and expectations are that these will persist, with little indication as to what Mr Trump's policy priorities would be once he assumes office in January 2017. However, one thing is nearly certain that protectionism which is on the rise will get a leg up. Not a good news for the Indian economy. Also with crude price inching up, US Fed raising the rates by 25bp as of now and likely to raise it further means reversal in capital flows and weakening of rupee. Simultaneous movement in crude prices and weakening of rupee will have an adverse impact on domestic inflation.

Amidst this uncertain global scenario, the Indian economy was cruising well and was expected to clock a GDP growth higher than FY16 on the back of a good monsoon till the tsunami of de-legalisation of high denomination currency hit the country. The sudden decision of cancelling the legal tender of Rs 500 and Rs 1,000 notes and the chaos created thereafter due to limited availability of new currency has caused significant disruption in the economy. The government's idea of moving towards a less cash economy may be a laudable move and it is likely to pay dividend in the medium- to long-run. However, in the short-run it has affected economy adversely. India Ratings believes, GDP growth in FY17 is likely to decline to 6.8% (earlier estimate: 7.8%). Various sectors of the economy have been impacted differentially. In agriculture it ranges from farmers not getting the right price for their Kharif produce to rabi sowing being affected by inability/low ability of farmers to purchase seeds and fertilizer. Even if finally there is no significant drop in the rabi sowing acreage, the output could still be lower on account of inadequate post sowing activities which mostly happens in cash.

As nearly 90% of the transactions in the country are executed in cash, this move has impacted the cash economy. The key segments of the economy where cash transactions play a vital role are real estate/construction, gold, and the informal sector. Although the role of cash transactions related to real estate and gold are mostly dubious, it is the lifeline in case of the informal sector. Also, by no means it could be assumed that all the cash transactions happening in the informal sector are black. Further, informal sector is not a standalone sector and has strong to weak linkages with the formal sector, depending on the nature of goods/services dealt in. Therefore, where business in the informal sector has come to a grinding halt or down by 30%-40% and beyond, it has resulted in either 'nil' or lower income generation.

Therefore, the ripple effect of de-legalisation is proving to be quite disruptive for the overall economic activity and employment. As the days associated with the loss of liquidity are getting longer, the impact is becoming severe and more pronounced in the informal sector. This in turn has the potential to push the default rate higher in both the formal and informal markets. Media, both print and electronic is full of stories about the breakdowns in payment systems choking trading activities across the board, and loss of liquidity leading to job losses. Disruption in trade in majority of the cases has permeated to the level of small vendors and street hawkers. Based on present situation, it is expected that the adverse impact may flow in FY18 also.

Against this broad domestic and global economic backdrop one of the major challenges for the government will be to firstly hold on to the growth momentum and secondly accelerate it. However, de-legalisation of high denomination currency notes has put a question mark on this. Therefore, as the government embarks on preparing the FY18 budget, the central question before it is - whether a fresh round of fiscal stimulus is required to offset some of the ill effects of currency de-legalisation. Indian public finances (central, state and local bodies) suffer from committed expenditure syndrome as a large part of current expenditure is inflexible and cannot be reduced/curtailed in the short-run.

Therefore the fiscal room for stepped expenditure has either come from higher revenue collection or higher fiscal deficit. With growth expected to fall not only in FY17 but also in FY18, government is clearly staring at lower tax collection.

For FY17, if we combine this with: i) lower revenue collection than was budgeted from telecom spectrum auction and ii) likely shortfall in disinvestment, then government finances do not appear to be heading towards budgeted numbers. However, government may still be able to cap the fiscal deficit at 3.5% of GDP due to a combination of i) higher growth in indirect tax collection than budgeted during 1HFY17,
ii) expected tax revenue garnered from Income Declaration Scheme 2016 and the proposed Pradhan Mantri Garib Kalyan Yojana (PMGKY) 2016.

Therefore, the headroom for the government to give stimulus either from the consumption side or investment side is quite limited and if it happens then perhaps it will require compromising fiscal deficit target and fiscal consolidation process. Any move in this direction will have its consequences. Moreover, unlike 2008, the slowdown in growth this time around is of our own making and the rationale for relaxing fiscal deficit target/consolidation process will not be viewed positively.

Further, rising commodity prices may also affect government's fiscal arithmetic. In case crude oil prices increase further and the same is fully passed on to consumers, it will make RBI's task of achieving 5% inflation target by March 2017 and 4% in the medium term very difficult. The government needs to be ready with alternate duty structure and move from ad-valorem duty to specific duty to maintain a fine balance between consumer inflation and tax revenue.

In all likelihood, the GST will miss 1 April 2017 implementation deadline. The budget should have some proposals from the government to bridge the trust deficit arisen between central and state governments especially after de-legalisation of currency.

In nutshell, we expect government's budget focus this year on:
1. Growth enhancing policies
2. Steps towards implementation of GST
3. Steps to attract investment
4. Steps to improve quality of education
5. Steps to boost revenue
6. Improve ease of doing business
7. Steps to improve capital inflows

The article is written by Dr. Devendra Kumar Pant, Chief Economist, and Dr. Sunil Kumar Sinha, Principal Economist, India Ratings and Research for FICCI's Economy Watch.

Union Budget 2017-18 should focus on economic stabilisation

While the Budget is widely perceived as the government's forecast of its expenditures and revenues for the coming financial year, the Budget's role as an "economic stabiliser" cannot be overstated. Fiscal instruments like public expenditures and taxation are widely used across the globe to reduce economic fluctuations.

The major backdrop for this year's Union Budget in India is "demonetisation"- a move launched by our government on November 8th to control black money and reduce the counterfeit currency that was in wide circulation. It was a massive move - a Decision of the Century – as per the government's own description. The high denomination notes withdrawn from circulation accounted for as much as 86% of total value of bank notes in circulation.

The sectors maximally hit by this move are the cash dependent sectors mostly belonging to the informal and agricultural and rural belts. Ground level channel checks and incremental data-points available so far, suggest a significant slowdown in sectors like agriculture, construction, gems & jewellery, textile, trade, transportation, etc. plus in most of the activities of the informal sector. A sharper contraction of PMI (purchasing manager's index) for services sector than for manufacturing sector and easing of services' inflation in CPI – in the month of November clearly show that "services", which are mostly unorganised in nature are being hit more severely.

The same is the case with labour-intensive exporting sectors like textiles, gems & jewellery, food processing, etc. that are cash-intensive in nature. Weaker readings of commercial vehicle sales in November signal a slowdown in transportation activity. So far as the farm sector is concerned, the monthly statistics on mandi prices and arrivals clearly reflects an impact of negative demand shock on the prices and trade of several kharif food grains. According to the rating agency ICRA, demonetisation will have some negative impact on the agricultural input sector during the "adjustment period" of demonetisation.

While "economic stability" would eventually return, the actual process of economic adjustment will be driven by how fast the new currency (with reasonable transaction value) will replace the old currency and the speed with which cashless transactions replace cash-based transactions.

This is a long drawn out process, especially for the country that suffers from large scale financial illiteracy and digital divide. Currently, the key challenge for both RBI and government is the logistics and printing of new currency. According to some expert estimates, it may take nine to ten months to get adequate number of new small denomination notes (with high transaction value) in circulation. This is a longer period than initially envisaged.

Moreover economic conditions prior to demonetisation were not much encouraging except for the normal monsoon rains in 2016. Corporate earnings results for Jul-Sept quarter of 2016-17 also showed widening of losses at stressed companies especially from the sectors steel, power and telecom.

The RBI's latest statistics shows that while bank deposit growth has reached a 54-week high of 15.9% (y-o-y) as on 9th December, credit growth has slumped to a multi-decade low of 6.2% due to higher repayments (partly coming from old notes) and subdued fresh disbursements partly on account of demonetisation (as banks are busy exchanging old notes) and partly due to increased risk aversion of banks.

Against this backdrop, the country requires fast and broad-based policy actions. Both fiscal and monetary policies will have to be expansionary in the "economic adjustment phase" triggered by demonetisation, to restore business and consumer confidence.

There is no doubt that "demonetisation" has increased the need for a more activist fiscal policy that can bolster incomes through increased investments in agriculture and infrastructure, rural jobs subsidies and social programmes focusing on education and industrial training.

As stated earlier, the rural, agriculture and informal belts have suffered a major jolt due to the lack of cash availability post demonetisation.

Moreover, this has happened when our rural economy was reeling under the pressure of four consecutive cash-negative crop cycles due to three muted monsoon years plus two interim episodes of untimely winter rains and hailstorms during 2013-2015.

Hence, the central theme of the upcoming Budget should be - "Agriculture & Rural Sector". While the government has already raised the minimum support prices of rabi crops to incentivise farmers, the Budget should give an added thrust to investments in key rural segments like irrigation infrastructure, rural roads, marketing & exporting infrastructure for rural belts, affordable housing and rural employment generation schemes to stimulate economic activity and cash flows.

To facilitate smoother flow of credit to agriculture and rural belts, all financial entities that cater to the requirements of farm credit whether commercial or cooperative banks or NBFCs or RRBs, MFIs, etc., should be subjected to uniform regulatory treatment. Given the impact of demonetisation on collections and recoveries of financial entities, some degree of regulatory forbearance may be considered during the phase of economic adjustment.

So far as the broader economy is concerned, wide ranging cuts in income tax (both business and personal) may be undertaken to counter the negative demand shock created by demonetisation and to revive consumption and investment sentiments.

To increase the speed of migration to cashless transactions, more incentives & sops will have to be offered for such transactions to ensure their quicker adoption.

The Budget should continue to focus on clean energy segments like solar & wind power and also on railways, highways & inland waterways, etc. that have stronger forward linkages and multiplier-accelerator effect on the economy.

So far as the power sector is concerned, wherein maximum stressed assets of banks are concentrated, the focus should be on faster resolution of non-performing assets of the banking industry. The Central government should create pressure on State governments to force Power Distribution Companies to clear the dues (~ Rs 3,000 crore), which is currently outstanding with wind power generation companies.

India's State governments have seen a sharp fall in their VAT collections especially in sectors like tourism, hotels and small-scale manufacturing. As demonetisation has destabilised "State Finances", the GST project should appropriately provide "compensation" to State governments for the losses incurred. The roadmap for GST should be suitably redefined to avoid more "disruptions" in economic activity.

It has been one and a half months since demonetisation was introduced and calls for central government to take over the relief effort are growing louder. Union Budget 2017-18 will be a good opportunity for the government to try to arrest economic slowdown to the extent possible, through a broad-based demand stimulus.

The article is written by Dr. Rupa Rege Nitsure, Group Chief Economist, L&T Financial Services for FICCI's Economy Watch.

The Union Budget 2017-18 is an opportunity to boost economic growth … but balancing multiple objectives will be tricky

The FY18 Union Budget will be presented at the crossroads of a momentous year gone by and a forthcoming one with risk of great uncertainty. The news is mixed, with signs of optimism from a seeming gradual global recovery, yet with portents of danger from various sources.

This Budget is likely to incorporate significantly changed processes, including presentation at an early date, folding in the Rail Budget, integrating Plan and Non-Plan expenditures and other signature changes. It also comes close on the heels of an unprecedented economic and social experiment which extinguished 86% of India's monetary base and at the beginning of a year which will probably see the introduction of another momentous reform of its indirect tax structure, the Goods and Services Tax GST).

There is significant uncertainty regarding a near term growth slowdown, but the Budget presents opportunity to use levers to sustainably stimulate growth.

Increased uncertainty in global markets, emanating from the yet unknown policy actions in the US, how Brexit negotiations in the UK might evolve, European elections and the state of its banks, as well as China credit growth and capital outflows. Global trade is unlikely to revive over the next year. Capital flows to Emerging Market are unlikely to pick up materially; even here, the countries which are commodities intensive are likely to benefit in a zero sum game with the commodities importers.

In India, despite significant policy and fiscal remedial actions, there remain significant impairments. Growth remains subdued, below its potential, confirmed by the official Advance Estimate of FY17 GDP. Capacity utilization rates have remained a low level stubbornly over the past few years, inhibiting capex plans. Corporate debt remains high, constraining their ability to invest in new projects, especially the larger ones.

In the aftermath of the notes withdrawal, while we still await the final numbers on cash deposits and withdrawals, increased direct personal tax receipts in FY17 itself is likely, which will offset some of the lost revenues from other non-tax revenues. Preliminary data analytics and trend estimation will also provide an idea of how much additional revenues the tax authorities might be able to cull as penalties and interest in FY18.

What is the best policy response to stabilize and then counter this reality? Assuming that that there will be extra revenues for Govt, via both tax and non-tax sources, how might these be spent to get the best stimulus for growth? And jobs? The extra revenues and the extent to which the recommendations of the FRBM Review Committee on easing the glide path of fiscal consolidation are accepted, will determine the extent of stimulus possible, and the buffer available for counter-cyclical spending. The response design must be calibrated for a phased series of impacts, from stabilizing economic activity and consumption in the near term, boosting investment over the course of FY18, even as it guides structural changes. How best to use the revenues?

As in all policy choices, the tradeoffs between various objectives and macroeconomic metrics will have to guide decisions. Fiscal and monetary policy will have to coordinate, but beyond a point, both have to balance various objectives. What are the relative benefits of a stimulus versus fiscal rectitude? Sovereign credit ratings are a very potent signal of global perceptions of India's potential. The original trajectory would have taken the Fiscal Deficit from the budgeted 3.5% of GDP to 3% in FY18. But this is not the time. The focus should shift from the deficit (flow) to the debt (stock). India's consolidated sovereign debt stock (Centre plus states) has actually been falling steadily, from over 72% of GDP in FY09 to an estimated 66% in FY16 (although sovereign debt levels are higher than most Emerging Market peers). The second metric for sustainable debt, that the nominal growth rate be higher than the interest rate, has also held true for a while.

With the expected additional revenues, and a considered and calibrated relaxation of fiscal consolidation norms, the allocation between stimulus to consumption and investment. A boost to consumption is essential to closing the persistent excess capacities, seemingly stuck at just above 70% for the past 3 years. But just as importantly, capex, particularly privately funded investment, needs to be revived. One driver of growth must be the series of ambitious infrastructure programs: DMIC, DFC, Sagarmala. The Budget must emphasise the potential of other powerful institutions: Indian Railways has the potential to singlehandedly aggregate both direct investment as well as facilitate a logistics boost to catalyse India's competitiveness.

Going beyond the revenues and expenditures arithmetic, the Budget should lay out the big picture themes for the next couple of years. India is on the cusp of transformative change. First, use the Budget to expedite the "once in a lifetime" introduction of Goods and Services Tax (GST).

Irrespective of the concessions to be given to states to co-opt into change, it will be worth the immediate loss, provided the concessions are offset by structural improvements.

To drive home the point of a transformative change, the focus areas have to be two of the most diffuse, yet critical cogs, critical for jobs, innovation and sustained growth. Both are intensely state subjects. India's low agriculture productivity is the most inaccessible low hanging fruit, offering huge potential, but is difficult to implement.

Summing up, the forthcoming Budget will be a very important milestone in India's economic growth. Investors and well wishers of India will look for bold steps. The Budget should strive to impart a path of policy stability, even while delivering a fiscal boost. The only way to create sustainable growth and boost employment is to make India more competitive, and rationalizing the tax framework is a key component in this.

The article is written by Mr. Saugata Bhattacharya, Senior Vice President and Chief Economist, Axis Bank for FICCI's Economy Watch.

Rebooting the Municipal Bond market in India

India's urban infrastructure is reeling under the immense pressure of the growth that the country is witnessing. While agencies have estimated varying amount of money required in infrastructure build out, one aspect is common – we are talking about funding of a large magnitude. At one hand, the High Powered Empowered Committee estimated Rs. 39 Lakh Crores for urban infrastructure investment, McKinsey Global Institute pegged the sum at Rs. 53 Lakh Crores. The Ministry of Urban Development has already approved smart city proposals for 60 cities under the Smart City Mission, totaling Rs. 1.44 Lakh Crores. That the urban local bodies (ULBs) do not have the resources to fund these requirements is a widely acknowledged fact. Accessing the capital markets is now an imperative and one of the options that is available with the ULBs is that of issuing Municipal Bonds.

CRISIL maintains that Municipal Bonds are the ideal instruments for raising resources, channeling funds from the capital market into infrastructure development. They are long-term in nature, unlike bank loans, which have a limited tenure. Instruments with longer maturity increase the ULBs financing capacities, in addition to providing opportunities for long-gestation infrastructure development projects. Debt markets also increase ULBs' access to capital for tax-supported projects. The biggest positive that Bonds have is that the bond-backed financing maintains community ownership of infrastructure related projects i.e. it keep public assets in public hands.

From an investor perspective, municipal bonds offer significant opportunities. Institutional investors need long-term paper to invest. The assets under management of life insurers and mutual funds are growing at 20-22% annually. Municipal Bonds offer much-needed diversification for such investors in a market dominated by large financial sector issuers. In the US, 75% of the money invested in Municipal Bonds comes from households (38%) and mutual funds (37%). These segments are virtually untapped in India.

Municipal Bonds are not new to the country. However, the growth in issuance of Municipal Bonds has been sub-optimal. The Bangalore Municipal Corporation issued the first Municipal Bond in India in 1997. However, the real catalyst for the Municipal Bond market was the Bond, without State guarantee, issued by the Ahmedabad Municipal Corporation in 1998. Between 1998 and 2010, several ULBs issued Municipal Bonds and raised capital for their projects. According to NIUA, Vaidya C., Vaidya H. and others, the total capital raised through Municipal bonds has been around Rs. 1,353 Crores.

Exhibit 1: Type of Bond Issuance and Amount Raised

Sr. No.	Type of Bond Issuance	Amount Raised (Rs. Crores)
1	Taxable Bonds	445.00
2	Tax-free Bonds	649.50
3	Pooled Finances	258.60
	Total	**1353.10**

Municipal Bonds, however, have not really become a norm for raising capital for the ULBs. There are several reasons for this.

Municipal bond issuances have happened in the past with and without State Government guarantees. The Reserve Bank of India has discouraged municipal borrowings with State Government guarantees. This closed the door on such issuances. In other cases, ULBs, which have had buoyant source of revenues viz. octroi, could generate the revenue surpluses, which could be leveraged to raise money through municipal bonds.

ULBs in Gujarat such as in Ahmedabad, which were active borrowers, had octroi as their revenue source, saw octroi abolished in 2008. The advent of GST will make octroi and its variant local body tax unconstitutional. Thus, ULBs will have limited means to raise any kind of commercial borrowing.

Indeed, recent years have seen considerable effort towards removing the regulatory hurdles that keep ULBs from tapping this market. In 2015, the Securities and Exchanges Board of India (SEBI) issued a regulatory framework for municipal bonds in India.

Under these regulations, municipal bodies or a corporate municipal entity (a body corporate registered under the Companies Act and a subsidiary of the municipality formed for raising funds) can issue municipal bonds through private placement or public issue. ULBs with investment-grade rating, with no default in the past 365 days, only can issue bonds.

Additionally, the ULB needs to have adopted transparent accounting practice based on the State Accounting Manual or the National Municipal Accounting Manual. A bond rating is also mandatory. The regulation also provides for a 100% asset cover on the debt and provision of a buy-back option.

The regulation also mandates, in case of public issue, a guarantee from State Government or Central Government or a structured payment mechanism where the issuer deposits debt servicing amounts in the designated bank account at least 10 working days before due date of payment.

Exhibit 2: Public Issuance vs. Private Placement

Public Issue of Municipal Bonds	•Can issue only revenue bonds with revenue escrow mechanism •Tenure of minimum 3 years & maximum 30 years •Separate escrow for debt servicing •Meet all disclosure requirements as per the guidelines •Funds to be used for projects specified •Issuer to contribute mini. 20% of the issue cost thorugh own resources •Must mandatorily list on a recognized stock exchange
Private Placement	•Can issue Revenue bonds or general obligation bonds without earmarked revenue stream •Subscription amount to be a minimum of Rs.25 lakh per investor •May list the privately placed issue on a recognized stock exchange

Notwithstanding the removal of these hurdles, the following three conditions acting solely or in unison will be necessary for the development of the municipal bond market:

1. **Presence of a buoyant municipal revenue source**

The presence of a buoyant revenue source provides direct linkages to economic activity and consumption in a city – a characteristic none of the other sources possess. Given that cities are India's economic engines, it is imperative that they have a revenue source directly connected with the activities they are expected to foster. Second, being an own source of income, it provides predictability and certainty in its quantum and timing, which allows the ULB to undertake multi-year capital investment planning.

Third, any substitution of octroi will need to find its source on an additional levy/ charge/ surcharge and cannot be compensated from existing revenue sources in a sustainable manner. Hence, if the ULBs are to take the bond route, the government must strengthen their finances by providing a buoyant revenue source.

2. **Revenue optimization from property tax can result in significant gains for the ULBs**

The other potential driver for municipal revenues is successful efforts of the ULBs to optimise revenues from existing sources viz. property tax. At Rs.15,000 Crores annually, India's property tax to GDP ratio is about 0.15% (2012-13). As per a study by NIPFP, improving coverage and increasing tax collection efficiencies can increase this ratio to 0.8%.

A 25% increase in rates, if factored in, will increase this ratio to 1% of GDP. Given that in many cases tax rate revision has been pending for many years, increase of the tax rate is not an unreasonable measure to explore. At 1% of GDP, property tax potential in the country is Rs.120,000 Crores against Rs. 15,000 Crores collected today. Even if 50% of the tax potential is realised, additional revenues per annum will be Rs.45,000 Crores. This money can leveraged to issue bonds and / or any other kind of borrowing.

3. Leveraging Central Finance Commission grants

The 13th and 14th Finance Commissions (FC) recognised the need to support the local bodies through a predictable and buoyant source of revenue by giving a share from the divisible pool to the latter. The 13th FC had provided for Rs. 24,330 Crores for five years from 2010 to 2015. The 14th FC increased this allocation to Rs. 87,143 Crores for the five-year period (2015-2020). In percentage terms, incremental revenue gains on an average were 5% and 15% under the 13th and 14th FC respectively. However, if we exclude the two states of Maharashtra and Gujarat, which have relatively stronger municipal revenue bases, the gains are 7% and 23% under the 13th and 14th FC respectively. The devolutions under the Central Finance Commission will continue to increase in the coming years with an increasing proportion of population living in urban areas.

Exhibit 3: Central Finance Commission grants

State	All India		All India excluding Maharashtra and Gujarat	
	13th FC	14th FC	13th FC	14th FC
CFC Devolution in Rs. Per Capita	129	488	129	488
Per capita municipal revenue, in Rs.	2,546	3,183	1,824	2,085
Incremental gains for ULBs in%	5%	15%	7%	23%

These cash flows, currently at Rs. 488 per capita of the urban population, can be leveraged or serve as credit enhancement mechanism for issuance of municipal bonds.

The above three conditions can potentially develop a sustainable Indian municipal bond market. They can serve as a huge boost for the massive investment requirement in the urban infrastructure sector, if used judiciously.

However, ULBs will have to implement several reform measures to improve their operational efficiency and financial health and improve their public disclosures to meet the regulatory requirements progressively.

The article is written by Ms. Ashu Suyash, Managing Director and Chief Executive Officer, CRISIL for FICCI's Economy Watch.

Trends in Start-up Ecosystem and Financing

Overview

The context: The impact of start-ups has been significant in all walks of life. In recent years, India has emerged as one of the top three countries globally in terms of the number of start-ups founded. The total venture investment in start-ups during the period 2005-15 is estimated at ₹1117 billion (using 2015 as the base year). Actual investment could be much higher since details of investment amount are not available for many of the deals. The average annual growth rate in investment flow during the period 2005-15 is about 42 percent. Between the years 2005-15, more than 10,000 start-ups have received funding.

The average annual growth in the number of start-ups that have been funded for the period 2005-15 has been 16 percent. In most sectors, there has been an equivalent Indian start-up to that of a foreign start-up. While many foreign start-ups have also started operations in India, the presence of an Indian start-up meant that the Indian consumer need not have to wait till the foreign company started operations in India.

Global and Indian start-up landscape: Indian start-up landscape is very vibrant as seen by the number of companies founded. In some of the sectors, the number of companies founded in India is close to the number of companies founded globally. The average investment per round in a start-up is higher globally, but the difference is not very large. A major concern would be the low proportion of start-ups that get funded in India. For example, the percentage of global start-ups that are able to successfully raise capital in the grocery tech, healthcare and consumer healthcare, and smart home and home improvement are 41 percent, 52 percent, and 36 percent respectively.

The corresponding percentage for Indian start-ups are 5 percent, 10 percent, and 11 percent. There is a time lag in the setting up and funding between global and Indian start-ups.

The growth and the funding of the Indian start-ups in different sectors occurs later than what is seen for global start-ups.

The report: In this report, we analyze the key trends in start-ups and start-up ecosystem in India. Broadly, the report includes the following components: incubation, accelerators, angel investors and angel networks, and venture funds. An important feature of this report is an analysis of the pool of start-ups that get founded and not just the start-ups that get funded. A comparative analysis of start-ups that have been funded and those that have not been funded provides interesting insights.

Incubation facilities

Pivotal role of universities: About 56 percent of the incubators are located in universities, indicating the important role played by universities in supporting entrepreneurship and start-ups. One third of the incubators are located in private universities. Incubators in universities supported 58 percent of the total incubatees being supported in different incubators. In addition to the traditional teaching, research, and industrial collaborations, universities are increasing playing a very important role in creating ventures.

Sector focus: Technology sector is supported by the largest number of incubators. After technology, the healthcare sector occupies the second position in terms of the number of the incubators supporting it. Telecommunications, industrials, and consumer goods come close, in terms of the third spot. The number of incubators supporting the other sectors are very limited. Incubation is not seen as the preferred approach in commercializing innovations such as in utilities or in the oil and gas sector.

Growth in incubator presence: More than 50 percent of the incubators were set up in the last five years. While the number of incubators in different types of cities were more or less equal till 2010, there has been a dramatic increase in the number of incubators in Tier 1 cities after 2010.

Incubation thesis varies between incubators: Average number of incubatees supported in the different type of incubators vary widely. While the average number of incubatees is around 36 in universities, it is only 13 in the case of private non-universities. This indicates that different type of incubators could have different investment thesis. Independent private sector incubators without any university affiliation might have more stringent criteria because the financial sustainability of the incubators could depend on the success of the incubatees. On the other hand, incubators supported by the government institutions could have the primary objective of encouraging start-ups rather than just financial success, and thus they are prepared to support more number of incubatees.

Accelerators

While incubators are present across different locations in the country, accelerators are essentially an urban phenomenon: Except for a couple, virtually almost all of the accelerators are located in the main cities – Chennai, Bengaluru, Hyderabad, Mumbai, Ahmedabad, and New Delhi. The highest number of accelerators are found in Bengaluru, followed by the NCR region and Mumbai.

Scale of the accelerator programs: In our sample, 17 accelerators have supported a total number of 1816 start-ups. Though some of the accelerators like 500 start-ups, Kyron, TiE Bootcamp have been associated with a large start-ups, in general, accelerators are able to guide more number of start-ups as compared to that of incubators.

Angel Funding

Angel investments in Tier 1 and 2 cities: Companies in Tier 1 cities are getting funded earlier and obtaining larger amounts of funding. Average deal sizes for companies in Tier 1 cities are about 62 percent higher than that of deals in Tier 2 cities. Investment rounds are more than 40 percent higher in Tier 1 cities as compared to that of Tier 2 cities.

Growth in angel investments: Angel deals have shown an annual average growth rate of 124 percent during the period 2008 – 15.

The estimated investment amount through angel deals has grown at an annual growth rate of 205 percent during 2008-15. The number of angel investors also has grown at an annual average of 107 percent during the above period. While the number of first time angel investors has grown at a rate of 98 percent, the growth rate of investors who are reinvesting has been 105 percent.

Age of start-ups at the time of receiving angel investment has consistently decreased: There has been a steady decrease in the average age of the start-up at the time of receiving angel investment from 4.77 years in 2008 to 0.54 years in 2015, indicating that age of the start-up at the time of investment has reduced by about 27 percent annually. However, the average investment amount has increased.

Profile of angel investors: Analysis of the angel investor sample indicated a good mix of experienced (i.e., who have made five investments or more) as well as new investors (i.e., who have made less than five investments). The proportion of the former was 48 percent while that of the latter was 52 percent, indicating that the mix of angel investors is well balanced. In terms of their professional background, senior executives from large corporations comprised the largest segment, accounting for more than half of the investors. Entrepreneurs comprise the second highest category, accounting for close to 40 percent of the investors. The traditionally wealthy, i.e., those engaged in family businesses account for less than 9 percent of the investor sample.

Location of angel investors: Analysis of registered angel investors in Lets Venture platform shows that 88 percent of those are from Tier 1 cities. The number of angels in Tier 2 and 3 cities are 11 percent and one percent respectively. Among the six tier 1 cities. Delhi (i.e., the National Capital region that comprises of adjacent cities to Delhi such as Gurgaon, Noida, and Okhla) has the largest number of angel investors, followed by Mumbai and Bangalore. Taken together, these 3 cities account for 88 percent of the total angel investors in Tier 1 cities. The remaining cities of Chennai, Hyderabad, and Kolkata account for only 12 percent of the total investors in Tier 1 cities.

The active as well as the occasional angel investors have a part to play in the growth of angel investing: Angels investors were classified into two separate quartiles based on the number of deals and the amount of investment. Based on the number of deals it was found that top quartile investors have a higher degree of sector concentration with most investments in technology whereas the bottom quartile investors exhibit a higher degree of diversity in terms of the number of deals in different sectors. Based on the investment amount, it was found that the active angels invest lower amounts per deal, but make more number of investments whereas occasional angels on an average invest higher amounts per deal. As a group, the aggregate investment made by occasional angels are also higher than that of active investors.

The rise of angel networks: A noteworthy development in the last few years has been the evolution of the angel networks. While many of the angel networks are organized around cities (such as The Chennai Angels, Mumbai Angels, and so on), there are other forms of networks as well. The annual growth rate of the number of investments by angel networks made during the 2009-15 period has been about 75 percent. In a span of 7 years, the number of networks have increased 20 times.

Average investment amounts made by angels have consistently increased: The average investment received from an angel round by a start-up has increased from ₹10.63 million in 2009 to ₹46.76 million in 2015 indicating an annual growth rate of 27 percent. The average investment made by an individual angel investor has increased from ₹2.16 million in 2009 to ₹16.95 million in 2015, indicating an annual growth rate of 34 percent. Individual investments made by angels in a networking platform are lower. For example, data from Lets Venture indicates that the average investment per investor was about ₹11 million. The number of investors is the highest for the average commitment amount of ₹500,000, followed by ₹1 million. Beyond that, there is a sharp fall in the number of investors, indicating that the sweet spot for investors in an angel networking platform is between ₹0.5 – 1 million.

Venture Funding

Contours of start-up founding differ from that of SME's: The geographical spread of SMEs and start-ups show interesting variations. Tamil Nadu and Gujarat has the highest number of SMEs, but they are not the top states in terms of venture funded start-ups. On the other hand, Karnataka and Maharashtra, which account for the highest number of venture funded start-ups do not occupy the top slot in terms of number of SMEs. This indicates that the ecosystem for development of SMEs and start-ups could be different.

Venture funding is concentrated in Tier1 cities: The 6 Tier 1 cities of India received the largest chunk of investment of ₹661.29 billion, accounting for about two-thirds of the angel and venture funding. Tier 2 cities received 31% of the total investment (about ₹306 billion) and start-ups in Tier 3 cities accounted for only ₹19.74 billion, which is about 2 percent of the total investment. There exists a big gulf in investment flow between start-ups in Tier 1 cities and the other two tiers.

Comparison of funded and non-funded start-ups

Maturity index of start-ups that have received funding are higher: Maturity index of start-ups were calculated based on the lifecycle stage of the start-up. The average maturity index of start-ups that have received funding was 3.54 whereas those that did not get any funding was 3.00. Start-ups that were a part of incubation or accelerators also had a higher maturity index (3.4) as compared to those that did not receive any incubation or acceleration support (3.0).

Incubators and accelerators can increase the probability of getting funding: In the overall sample, only 8.3 of the start-ups are successful in getting external funding. But among those who have been a part of an incubator or accelerator, 24 percent have been able to get external funding. Thus incubators and accelerators have been able to increase the chance of getting funded by about three times.

Similarly, 5 percent of those who have been with an incubator or accelerator have been able to get funding on the LetsVenture platform, while the proportion of those getting funded on the platform for the overall sample is only 1.1 percent. Incubators and accelerators have thus been able to increase the chances of getting funded on the LetsVenture platform by five times.

Odds of success for getting funded continue to be low: In our estimate, for every 875 start-ups that get founded, only one is able to successfully raise 4 or more rounds of funding. Out of the total start-ups that get founded, about 6 percent take part in an accelerator or incubation program. 75 of the 875 are able to get first round of funding, out of which only 15 are able to get the second round of funding, and only 5 are able to secure the third round of funding.

The line of separation that distinguishes the funded and non-funded start-ups can often be very thin: The case study of Keiretsu Forum, Chennai Chapter, indicates that the average number of positives (or concerns) is just higher by a count of 2 (or lower by a count of 2) for the invested companies as compared to that of non-invested companies. Similarly, the average prior investment made by companies as seen from Chennai Angels is not very different between the invested and applicant companies (₹7.98 vs ₹6.88 million respectively).

However, the case studies also provide various pointers on increasing the probability of success. The most common causes of rejection of proposals has been limited interest among the angel network members, low traction, and scalability issues. Data from Keiretsu Forum indicates that the strengths of the business model, the value proposition, and market size are significant factors that influence the investment decision.

The count of concerns for companies that were not successful in receiving investment was considerably higher for the following parameters: business model, customer traction, margins and profitability and market size.

Approaching the funders through a reference can improve the odds of funding: Increasingly, investors are relying on developing a proprietary deal flow network. For one of the venture firms interviewed for this report, 37 percent of the deal flow was through personal contacts. In terms of the importance of references, the finding from The Chennai Angels case study provides an important perspective. Ninety two percent of the investments made by The Chennai Angels were sourced through or had a reference from angel investors or members of the angel network. None of the deals that were received directly without any reference were successful in getting funding.

The article is written by Dr. Thillai Rajan A., Professor, IIT Madras and International Research Affiliate, Coller Institute of Venture, Tel Aviv University for FICCI's Economy Watch.

Create an eco-system of entrepreneurship

In our country, there is a huge problem of finding clean comfortable hotel rooms in the budget segment. When I was growing up, we often used to go to religious destinations. More often than not we stayed at our relatives' homes because there were no clean mid-market places to stay. Five star hotels were the only category where a traveller received an experience as per some set or known expectations. Further, there were no budget-hotels chains with a pan-India presence. So even if one knew a good hotel in city A, you would be in the same quandary if your travels took you to multiple cities. This idea wasn't a great revelation, it had existed for a long time. After my twelfth grade, I was travelling continuously for three months. At that time, I visited nearly 100 hotels - from budget properties, inns to bed-and-breakfasts - and I found something common in each place - they were unpredictable and there was a surprise waiting every time I checked in. At one of the places, the beds would be tall, at the other, the washrooms were not clean. Some other places didn't accept a credit card, or had no kitchens to serve meals.

From understanding these problems, to creating a business model around it and further convincing people to invest in that idea, and then to run the business - these are very critical steps and many entrepreneurs or start-ups can falter in any of these for various reasons. However, things worked out for me. While luck does play a factor, there are two important things to ensure that you keep on jumping across the hurdles. To be a successful entrepreneur, the first thing is building a great team of people. Most entrepreneurial ventures in India are run by the founders and their friends. I spent close to a year trying to bring some of the smartest people into our team, who were not only sharp but could also roll up their sleeves when required.

Entrepreneurship doesn't restrict itself to age. I was just out of school, trying to convince industry veterans to work with me. This was extremely difficult, but I have observed that if you speak sense, and talk about something that people can resonate with, along with some validation, it always works out. I was lucky I had the Peter Thiel Fellowship validation. There were few angels who had chosen to invest in the company.

So there was always some validation to the cause I was working towards. And of course, some of these were genuinely very good people to choose and work with, which is why we were able to build a very solid leadership, incredible professionals in each of their fields. For example, the CFO, CXO and people at the strategic planning level are all veterans in their fields of execution.

Secondly, for an entrepreneur, being true to your idea and not giving up your ambition is the key. For instance, we have set up a small training academy to graduate students through our own training systems. The reality is that if you look at the current convention, new age digital companies are not expected to do all this. However, for us, delivering service is the top priority in whatever we do, which is why we not only have this training academy, but we also have more than 300 of our staff on the field in different cities to ensure we can standardize the facilities and audit them after every three days, to ensure service is extraordinary. If our guests need any service, we are there in person to deliver the service. A good entrepreneur is a good nurturer.

The idea of OYO came about during the phase where I was switching from our old brand Oravel, to our current brand OYO. What was interesting was during this phase, I learnt from many other entrepreneurs that building something new is very important. So we are a unique company solving a local problem and not an emulation of any US company. The reality is that at present 30 other companies outside India are emulating us. Thinking big is an important factor. Initially we used to think that we will have 10 properties, but over time, our aspiration grew - to aim to become one of the world's largest hotel chains. This has brought us to the present scale where we are India's largest and world's 14th largest hotel network today. We have a clear direction to become the world's largest hotel chain especially because of the capabilities we are building.

In India, the last two years have been a great opportunity for nurturing entrepreneurial mind-set. However, there is still a need for the social outlook to change towards entrepreneurs in India.

I agree with our Prime Minister who has stated that our country should be a country of entrepreneurs. When people see that and parents hear that, when a kids comes up and says to his parents that I want to be an entrepreneur, it's not that tough anymore for a parent to say that my kid will become an entrepreneur. But people need to understand that building your own business is very hard work. Nowadays, people love the hype and aura associated with Silicon Valley but they are not willing to respect or recognize failed entrepreneurs. This is a wrong mindset. If you don't fail, you don't learn. How many times did Einstein make the bulb prototype before he succeeded? Remember there will be failures and we should celebrate failures. It is also true that we as a country have never done that. The best entrepreneurs have also failed a few times in their lives.

It is now imperative to ensure that reality starts keeping up with the hype that is being created, which means there are real companies, creating real products and globally they are becoming powerhouses as organizations. This is fuelling the entrepreneurship revolution to the next level. For example, in the US when the first entrepreneurship revolution started with people like Henry Ford, Andrew Carnegie, they generated huge amount of wealth and then invested in new age companies to make USA the country of entrepreneurs. China has similar examples as well. India must become the country that will create relevant entrepreneurs who solve large global problems of the future.

It is difficult for policy makers to suggest changes, especially in this sector. Entrepreneurship is dynamic. The world is changing very fast and to keep up with these changes, the policy makers need to become consistent enablers rather than doers. The policy makers should recognize ten things which can be done to open the market and let new people come in and start operating or creating new products. My request to policy makers would be to become enablers for innovation and entrepreneurs. The youth should realise that to reach a certain place and to change the world, it is a hard journey. If you choose to get in there, then become perseverant and hardworking. I have been in this industry for the last four years and what I have seen in this industry is that you need to work hard and persevere to reach a place where you start making an impact on the society and stay focused on that.

In my mind, hospitality is one sector which is waiting to create hundreds and thousands of jobs and clearly so, because of a couple of reasons. We at OYO want to recruit people for our self-run properties as well as franchise-run properties. In both of these, we see employability. The workforce is not skilled, they are not trained enough to do things in a specific manner. This is why we have invested in our training academy to skill people and ensure they reach levels of competency to come and work together. We see incredible passion among them to join and work with us. We have recently signed a partnership agreement with the Skill Ministry as well, to train 30,000 graduates over the next five years and employ them in the hospitality industry.

We cannot run away from the technological revolution. There will soon come a time when we will not need humans during the time of check-ins. It will all be automated. However, when people are replaced with technology, there isn't a zero sum game because hotels have been struggling for a very long time to build a great culture inside their accommodation. We are investing heavily on front office staff, who can be great community managers and not restrict themselves to their daily mundane jobs.

Hospitality, by definition, means welcoming and making people comfortable. Indians are known for their hospitable nature. But today, there is a lack of adequately qualified people for this industry. To solve the problem, we need the government to help in facilitating training and empowering the workforce. Additionally, the industry or the private sector players need to ensure that there are sufficient employment opportunities for skilled people entering workforce. India already generates smart graduates, but the compensation in hospitality industry is not up to the mark. Thus people start looking out of this sector for better opportunities. We need to make sure that these smart graduates are employed with a good life so that they can further influence others in their network of family and friends. The youth should look at hospitality as a lucrative career option.

The investment in the transition needs to be done by the government and the private sector in collaboration. However, reality is that private sector needs to do more than the government. The government is doing a great job as enablers in the last few years. Talent however still remains one of the biggest concern in the hospitality sector. In tier 3 or tier 4 cities, we have adequate number of people but not enough skills, visibility, understanding of best practices, work ethics and culture. Given that hospitality has a segregated market, technology is the best way to reach out to people. At OYO, all our content is fully digitalized.

There are two important skills which we want in this sector, empathy and soft skills. Earlier, if someone wanted to join the hospitality sector, they had to leave their home, go 300 km away from home for two years for training or college.

Whereas in today's time, they can go just 500 meters away from home and learn all this online from a computer.

They can probably take an exam on their mobile phone and clear the first level in hospitality. Further, they can take break from their regular work for two hours and undertake the course. Digital education is thus a very big focus for us. We have already started working on this and in next six months, we will build a complete set-up where anyone can come and work with us, to ensure quality of talent is retained and hospitality is seen as the choice of industry to work in the times to come.

In the next three to five years, we plan to target more than a lakh people through our initiatives. We believe this industry is growing at a ferocious pace and we can indeed do something better and on a bigger scale and create large scale employment.

The article is written by Mr. Ritesh Agarwal, Founder, OYO Rooms. It was published in the book 'Economy of Jobs' – a compilation of articles from eminent industry players, released during the 89th AGM of FICCI on 17th December, 2016.

Employment opportunities - entrepreneurship and flexible labour laws

The latest labour bureau survey data shows that the unemployment rate is estimated at five per cent - highest in the last five years. This is a matter of concern. When it comes to job creation in India, especially in manufacturing, the situation is deplorable. India is a labour surplus country with 47 million unemployed people who are below the age of 24 years. Additionally, almost 12-13 million youth join the labour market every year. We cannot depend solely upon existing manufacturing and service organisations to provide employment to such a large number of youth. The only effective solution is to promote entrepreneurship.

Entrepreneurship is the key

I firmly believe that entrepreneurship should get the boost it rightly deserves. If everybody is looking for jobs, somebody has to provide jobs and that somebody has to be small, medium and micro enterprises. The aim should be to create job creators. I believe if we need one crore jobs, we need ten lakh entrepreneurs.

To create a robust eco-system of entrepreneurship in India, a critical change which is required is the societal change. In India, failure is generally not tolerated. However, in entrepreneurship, failure is a must. You start something, you fail, you start something again and then you succeed. We, as a society, must learn to appreciate failure. Such societal change does not come automatically. I believe that government can play an important role by way of some 'Affirmative Action Policy' for new entrepreneurs. For instance, the government should provide equal opportunity to new entrepreneurs (without experience) to participate in various tenders, subject to the conditions of quality and delivery.

Another aspect that requires a change in outlook is that of lenders towards new enterprises. Even today, if a new enterprise fails, the promoter and his family are often harassed by lenders for recovery of money. When a man takes a risk, he would either succeed or fail. Failure of business is not a crime, fraud is. Hence, fraud should not be mixed with failure. Policy intervention would help in bringing about change in such outlook.

Over the last two years, some positive steps have been taken by the government to promote self employment, specifically Start-up India initiative which is aimed at encouraging and developing entrepreneurial skill. Unlike in the past, the new entrepreneurs can now have a relatively easy start with no inspection and income tax for three years, exemption from capital gains tax on personal property invested in start-up, 80% rebate on patent filing fee and option of easy exit under the new Bankruptcy Law.

Likewise, the Stand-up India scheme provides financial and consulting assistance to entrepreneurs from under privileged segments as well as to women entrepreneurs. Under the scheme, every bank branch has to provide at least two collateral free loans to entrepreneurs from these segments ranging from Rs. 10 lakh to Rs. 1 crore. These are positive initiatives and need to be implemented effectively.

Industry leaders can also take the lead by playing the role of mentors. We can share our experiences which would help the upcoming entrepreneurs. Apprenticeship training is one of the most efficient ways to develop skilled manpower for the country. For the first time in India, the government has recently notified a National Apprenticeship Promotion Scheme, which incentivises enterprises to take apprentices. Under the scheme, 25% of the prescribed stipend payable to an apprentice would be reimbursed to the employers directly by the government. All these are positive steps that need to be scaled up and followed with more supportive policy initiatives.

Relook at the labour policies

A very small portion of India's total labour force is under the organised sector, and this sector has seen very slow growth in employment. The key reason for this is the country's rigid labour laws and excessive regulations, which discourage entrepreneurs to hire permanent workers and they prefer employing informal or contract labour. One must recognise that manpower is a resource and skilled manpower is very precious. Job creation is, in essence, a question of demand and supply.

The labour laws and policies should thus be framed with an approach and understanding that people want to work and employers want to hire. Thus, the need of the hour is flexibility and flexibility does not mean hire and fire.

In particular, there is a need to review the rigid labour laws, especially Chapter VB of the Industrial Disputes Act, which was introduced through amendments in 1976 and 1982. However, one aspect, which deserves to be looked at in this connection, is that of compensation to the workmen in the event of retrenchment or closure. The Act stipulates that, as a rule, the compensation should be the average pay for fifteen days for each year of continuous employment. Such compensation is pittance. Nowhere in the world is the compensation so low. In my personal opinion, compensation should include a year's remuneration. So, while removal would be rendered easy, higher compensation would serve as an economic disincentive to dismiss employee(s) unless necessary.

What is needed from government is a framework that helps entrepreneurs to hire. Labour policies should be inclusive. Unemployed workers should have access to some form of unemployment insurance and appropriate training to enhance their employability.

Another aspect of labour reforms is to reduce the complexities. Currently, there are 44 labour laws under the purview of Central Government and more than 100 under State Governments. The entire gamut of the labour laws should therefore be simplified, clubbed together wherever possible and made less cumbersome to make the environment more employment friendly.

Additionally, there is a need to incentivise employment generation. In the last Union Budget, the government took an extremely positive step in this regard by agreeing to pay the Employee Pension Scheme contribution of 8.33% for all new employees for the first three years of their employment. Recently, the government also announced a special package for apparel sector to help create one crore additional jobs over the next three years. As a part of the package, the government has introduced fixed-term employment and brought parity between the contractual and permanent labourers in terms of wages and all other incentives. This is an important step that can potentially be replicated in other industries as well.

Likewise, many State governments have started undertaking labour reforms. For instance, Rajasthan Government has relaxed the Trade Union Act, Industrial Dispute Act, Contract Labour Act, as well as the Factories Act and Apprenticeship Act to spur economic development and attract foreign investment. As per the amendments introduced, industrial establishments employing up to 300 workers are now allowed to downsize without seeking prior permission of the Government. The threshold of the number of employees required for the purpose of applicability of the Factories Act has also been increased from 10 to 20 (in electricity-powered factories) and from 20 to 40 (in factories without power) thereby putting small factories in Rajasthan outside the purview of the Factories Act.

To fix the employment outlook of the country, the government should fix the policy, where employment generation and job creation should be emphasized more, so as to promote entrepreneurship and self-employment.

The article is written by Mr. Y K Modi, Past President, FICCI and Executive Chairman, Great Eastern Energy Corporation. It was published in the book 'Economy of Jobs' – a compilation of articles from eminent industry players, released during the 89th AGM of FICCI on 17th December, 2016.

Dilemmas of the diligent promoter

India needs investment in all sectors — agriculture, industry, services and infrastructure — without which anticipated economic growth and worthwhile livelihoods (self-employment or jobs) will not materialise.

Finance Minister Arun Jaitley recently confirmed that public and foreign investment remain intact but private sector expansion (participation) is needed in a big way for the economy to fire up to its potential. He also hinted that returns here for foreigners might be greater than almost anywhere else.

Foreign firms have the advantages of low direct cost of funds and of capital which is willing to wait for returns — a luxury which we do not have. They additionally leverage brand/intellectual property as part of global strategy, which yields profits here and valuation multiples for them at home.

Still, I believe in-depth consideration is warranted as to why private investment remains elusive.

Should not the potential of profits and value-creation (that foreigners presumably see) inevitably trigger investments by Indians? If they don't, should we not try to understand why?

Promoters maligned

I relentlessly pursue the contention that commitment of desi (homegrown) entrepreneurs, new or old, is the surest endorsement that can prompt all future investment from home and abroad.

There are those who risk a material skin-of-their-own in the game (including finance/reputation), and those who as professionals manage or mentor businesses funded by institutional capital or others' pockets. Loosely defined, the former are what our ecosystem calls Promoters. While not downplaying the roles of other entrepreneurs, I just point out that the motivations or outcomes for both categories are diverse in the long term.

The term Promoter is variously described in laws and regulations.

But I am more concerned with the "softer" side encompassing the risk-taking vigour to set up the business, assuming certain fiduciary duties and establishing and dynamically shaping ethical and business value systems of the enterprise.

These are all key to the long-term well-being of the business and its stakeholders.

It is sometimes argued, and sometimes owing to ugly confrontations, that Promoters don't always cover themselves in glory and leave lingering questions about their value to society.

In truth we must remember that like in every vocation — there are good, not-so-good, and occasionally dishonest persons. Happily, laws of averages apply to ensure that any bad apples are atypical and in significant minority.

Yet in a time of snowballing media avalanches, enterprises traditionally held out as paragons of virtue, trust and governance could be portrayed in ugly or undeserved light. Cacophony takes over. At such times it is maturity in the larger ecosystem that must separate the wheat from the chaff.

Promoters are diligent at their core; their intentions do not centre on undue enrichment, the basic aim being to earn risk-weighted returns on invested capital and — more often than not — undertake value building that can span at least a generation or two.

More often than not a large number of promoters have struggled through years of the control-raj and confiscatory-taxes era, without the benefit of any "ease of doing business" initiatives, and with the familiar ambience of discretionary power and lack of certainty in interpreting laws and regulations. Promoters don't only exist in industry but operate in every area —services, financial sector, education.

What then holds back such spirit from undertaking fresh risk when the future looks bright?

Draconian debt recovery

I have neither answers of my own, nor are investigative surveys particularly helpful. Professional surveys continue to exude confidence; most economic participants and commentators wax eloquent about better times — but never now, always “in the future”. So, one must only rely on a “sense of the house”.

It is vital to respect that entrepreneurs (old and new) will shun risk if they perceive that business difficulty or failure can classify them as delinquent, threaten personal slur or even personal ruin.

Loss of peer or systemic respect is as big a risk to promoters as a financial one. These risks climb in intensity if promoters as a class can even be perceived to slide from a place of pride in the eyes of society or in the attitudes of the administration. Unfortunately, I feel both have happened.

This risk becomes more relevant in an environment when untold notices, show-causes and “look-behinds” can rapidly follow up allegations. When judicial defence and disposal is almost surely delayed, risk aversion can outweigh risk appetite.

Will diligent promoters further prefer to wait and watch how policies and statements on debt recovery pan out in real life? After all the experience of a few bad eggs clearly impacts how all accounts are dealt with; years of goodwill could well vanish in a few moments of transient difficulty.

How do ground realities harmonise with growth statistics?

Future weak domestic and global demand may reignite the cycle of capacity underutilization and the perils of defaulted debts and other problems (including manpower).

New norms

How will the realities of tax administration (including GST) match up to the stated intentions of leadership? The gap has not really narrowed for businesses, and with impending introduction of GAAR (for domestics also) life may become difficult compared to the promise of ease.

How will the desired “hygiene” levels to support decision-making, discretion and implementation percolate from central leadership to the lower levels or the States? Realities in India are well known to citizens, businesses and foreigners, and hold out unspecified risks for enterprise.

Indian business also has the unhappy record of being caught on the wrong foot, with inadequate preparations; this happened with Companies Act/related SEBI regulations, accounting standards, could be happening with GST and may well happen with GAAR.

Let me evoke Ayn Rand in her novel Atlas Shrugged; in fiction, prominent and successful people abandoned enterprise. But more pertinent was her stated goal for writing the novel: “to show how desperately the world needs prime movers and how viciously it treats them” and “what happens to a world without them”.

We owe it to comprehend the dilemmas of the diligent. We cannot afford to let Atlas shrug!

The article is written by Mr. Sidharth Birla, Past President, FICCI. It was published in The Hindu Business Line on November 22, 2016.

Returns on business matter, not just ranking

Last month, Prime Minister Narendra Modi, while chairing his sixteenth meeting of Pragati, asked all Secretaries and Chief Secretaries to study the latest World Bank's "Ease of Doing Business" report and submit suggestions within a month on areas that can be improved. Never had the ranking perhaps invited such serious concern at the highest level. After all, having done so much in the last few months it was distressing to see India advance by only one rank. This just did not match the data of India receiving the highest ever foreign direct investment. We have seen some unprecedented growth in FDI equity inflows of 46% in the last few months. As compared to US$39 billion FDI equity inflows from February 2013 to September 2014, India received US$56 billion of FDI equity inflows for the period October 2014-May 2016.

Immediately after coming to power, the Prime Minister had set up an expert committee to repeal obsolete laws. The committee submitted its report and many identified laws were repealed. Countries like South Korea in the past have also taken hard measures to reduce the number of regulations by as much as 35% so as to make it easier for business to operate. This should work for India too.

The two World Bank reports, one on national and the other on the sub-national level were somewhat baffling. While the country report had seen an improvement by one position, the sub-national report (which deals with and compares the states), witnessed a dip in the ranking of Maharashtra and Delhi in 2016 vis-à-vis 2015. These are the states/cities (Mumbai and Delhi) sampled for the Ease of Doing Business ranking at country-to-country level and also the focus of much of the reforms in the last two years. On the other hand, in the sub-national report, it was heartening to see that the overall national implementation average for reforms at the state level stood at 48.93%, as compared to last year's average of 32%. A remarkable improvement.

The methodology of the report apart, ground reality in India is perhaps more complicated. The World Bank ranking is a country to country comparison, which requires a lot of assumptions to make comparisons possible.

For instance, under Construction Permit, setting up of warehousing is considered across the world, but that too a warehouse that is used for general storage of books or stationery and not for any goods requiring any special conditions such as food or pharmaceuticals or any chemical. This means, the need is for more deep seated and broad based reforms than just those indicated in the Ease of Doing Business report.

The timing of the reforms is important, but proof of the pudding is in the eating. Some of the areas like paying taxes and trading across border were the subjects most dealt with in the last few months, even then India's ranking didn't change much this year on these fronts. We need to have a regular feedback mechanism from the industry/user to understand the real issues and for any new reform introduced as is suggested by the government. A case in point is the single window interface for trade (ICEGATE) introduced by the government, that integrates approvals and risk based frameworks of customs and nine departments to provide traders with a single online interface for imports.

This measure has been well recognised in the World Bank report too. However, when FICCI was asked by the government to share industry's experience on the same, we received a number of issues on what plagues the system.

The integration is not complete and as a result despite being online a lot of human intervention is still required, leading to delays. Data transmission related to advance licence also leads to delays on the DGFT portal and in some cases the transmission fails, thereby forcing traders to apply again for the licence. (The detailed suggestion on this feedback has been submitted to Ministry of Commerce and Industry by FICCI).

Similarly, despite the introduction of online system of NOC for the height of buildings/chimneys etc (NOCAS) by Ministry of Civil Aviation, pendency of applications is a major issue which can be resolved if there is a regular feedback mechanism. There are many other such cases.

The cost of doing business is also a major factor for investors. Our logistics cost continues to be one of the highest in the world. Lack of infrastructure at ports are resulting in delays and cost escalation, impacting the competitiveness of exports. For example, due to the lack of dedicated lanes for export of vehicles at ports, it takes six to eight hours to travel a distance of just half a kilometre. In road logistics, a lot has been done, but it can be made easier for industry by introducing an integrated system of permission for moving inter-state cargo, with a national grid for load chart of bridges and prior permission mapping. Permitting regional authorities to grant permissions for movement of cargo on national highways and many such measures would go a long way in providing “ease” for business.

This year’s report included a pilot indicator on public procurement regulations in which the report studied procurement in 78 countries in terms of accessibility, transparency, payment delays, bid security, etc. In the future, it may be more challenging for India to improve its ranking in case such areas are also looked at by the World Bank for India. The delays in the payments in our public procurement system are well known.

More importantly, there are a host of other issues related to submission of voluminous tender documents every time, unilateral termination of contracts, guarantee/warranty and defect liability period, etc., that need separate discussions.

Having commented on the “ease of doing business” factors, it’s important to note that more important than and in addition to “ease”, it’s actually the overall business environment that matters even more. Business looks at returns on business, not just “ease”. In fact there are many countries in the World Bank report that score high on the “ease of doing business” index, but get hardly any investment. India, on the other hand, records one of the highest foreign direct investments and has been ranked third on the list of top prospective host economies for 2016-17 in the World Investment Report (WIR).

Today, each of the 29 states vie for that pie of investment and it is this that drives their desire to improve on the “ease of doing business” in their state. This competitive spirit is very much desired, but needs to be accelerated, with more deep rooted reforms both at the state and Central levels.

The article is written by Dr A. Didar Singh, Secretary General, FICCI . It was published in Sunday Guardian on December 3, 2016.

Global Talent Flows

Introduction

In today's knowledge economy, highly skilled workers play a crucial role as they make exceptional contributions including breakthrough innovations and scientific discoveries. In addition, they also co-ordinate and guide many others thus propelling the knowledge frontier and aiding economic growth. In this process, the mobility of skilled workers becomes critical to enhancing productivity. Global distribution of talent however is highly skewed and availability of appropriate resources to develop and utilize their talent varies substantially across countries. Increasing transnational flows of highly skilled individuals makes the distribution even more unequal.

World Bank's paper, 'Global Talent Flows' reviews the landscape of global talent mobility, which is both asymmetric and rising in importance globally. It studies the determinants of global talent flows and also highlights the causes and consequences of high skilled migration.

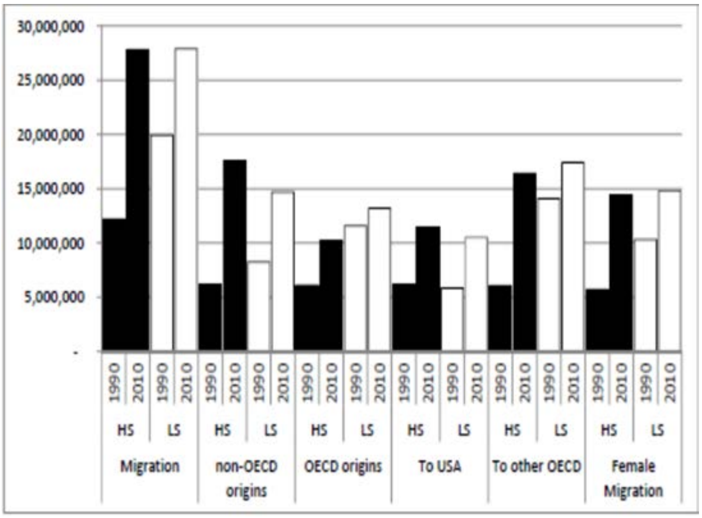
It further reviews the policies adopted by 'national gatekeepers' including the government, firms as well as universities, influencing the trend in high-skilled mobility. The paper concludes that a country's success depends largely on the successful management of the global talent flows.

Trends in Global Talent Flows

The World Bank research paper indicates that approximately 3% of the world's population lives in a country different from that of their birthplace. Though this proportion has remained stable over the years, the patterns in global migration however have become increasingly asymmetric and skewed, as skilled migration has become a greater force globally.

For the purpose of this paper, high-skilled workers are defined as those with at least one year of tertiary education, while the term 'low skill' is used to designate migrants with only primary education and 'other skill' to refer to those not classified as high-skilled via their education.

Chart 1: Migrant Stocks in OECD Countries in 1990 and 2010



Notes: Migration patterns taken from Database on Immigrants in OECD Countries and Docquier et al. (2009).

High-skilled talent flows to OECD

The report mentions that number of high skilled migrants to OECD countries rose by almost 130% to 28 million during 1990-2010 (from within OECD countries rose by 68% to 10.2 million and from non-OECD countries rose by 185% to 17.6 million). In comparison, growth of low skilled migrants in the OECD countries was only 40% during the same period. Interestingly, while the OECD countries constitute less than one fifth of the world's population, these countries host around two-thirds of high-skilled migrants. This exceptional rise in number of skilled migrants to OECD countries has been mainly due to the increased efforts made by the policymakers to attract skilled people as they recognized the central role of human capital in economic growth; positive spillovers generated by skill agglomeration; decline in transportation and communication costs; and rising pursuit of foreign education by young people.

The report observes an emerging pattern in which high-skilled migrants are departing from a broader range of countries and heading to a narrower range of countries which includes the US, the UK, Canada and Australia. These four countries accounted for nearly 70% of high skilled migrants (to the OECD) in 2010.

The US has historically hosted close to half of all high skilled migrants to OECD and one-third of high-skilled migrants worldwide. In 2010, it hosted (11.4 million) 41% of the skilled migrants to the OECD. France, Germany, Spain and other countries are also increasing efforts to attract high skilled migrants. The report further predicts, that owing to factors like the volume of migration to the US, the UK, Canada and Australia along with significant asymmetry in the concentration of leading universities, high-tech firms and research centers indicate that global competition for skills will remain fierce and unequal in future.

India – the largest origin country in 2010

The UK was the largest origin country in terms of number of outbound skilled migrants during the first two decades prior to 2010. However, in 2010, it was surpassed by India (2.1 million emigrants) and the Philippines (1.5 million). China too had about 1.4 million high skilled emigrants during the same year. During 1999-2010, Algeria, Russia, Bangladesh, Romania, Venezuela, Ukraine, Pakistan and India are some of the countries which recorded the greatest increases in high-skilled emigration.

It has also been observed that there is an inverse relation between the size of a country and the rate of high skilled emigration rates. Most of the countries that experienced particularly high emigration rates of high skilled workers to OECD destinations in 2010 are small low income countries and island states such as Guyana (93%), Trinidad and Tobago (68%), Barbados (66%), Tonga (53%), and Zimbabwe (44%). These countries have limited educational capacities and fiscal resources to train workers or to replace those who have emigrated.

Female migrants surpassing male counterparts

An interesting and remarkable component of the high skilled migration has also been the surge in stock of high skilled female immigrants in OECD countries by 152% during 1990-2010 to 14.4 million in 2010, surpassing the stock of high skilled male migrants. The paper highlights that while the reason behind this surge has not been traced fully, the fact that Africa and Asia experienced the largest growth of high skilled female emigration points towards the potential role of gender inequalities and labor market challenges in the origin countries as the push factors.

Consequences of migration patterns

A natural consequence of these migration patterns is that the host countries often end up with high concentration of high skilled immigrants in particular occupations. Citing an example the paper adds that immigrants account for some 57% of scientists residing in Switzerland, 45% in Australia, and 38% in the US. The other example it cites is of the US, where 27% of all physicians and surgeons and over 35% of current medical residents were foreign born in 2010. Inventors and Sports are the other two fields witnessing striking levels of concentration of immigrants, the report states.

Drivers of Skilled Migration

The key drivers of high skilled migration include differences in net economic advantage, mainly differences in wages; location which reflects institutional and educational differences across countries; productivity spillovers; agglomeration effects; and how both workers and employers interact with these differences.

Geographic locations provide different levels of access to financial and physical capital, technology, complementary institution and workers. All of these impact the quality and productivity of the available jobs; high skilled occupations show agglomeration effects, where an individual worker's productivity is enhanced by being closer or working with many other skilled workers in similar sectors or occupations.

Due to agglomeration effects, a surge of high-skilled migration increases the incentive for other high-skilled workers to migrate to the same location. Moreover, the agglomeration of activity in a specific location allows larger scale for complementary specialized inputs and providers.

Difference in educational opportunities is also one of the factors contributing to a substantial share of high skilled migration.

This is reinforced by the fact that the four countries accounting for 75% of the high skilled migrants, host 18 of the top 20 universities globally, as ranked by Academic Ranking of World Universities. In addition, schooling can provide an important entry point into desired labor markets for talented individuals.

Another factor driving skilled labor migration is that many multinational companies often insist that their rising executives live and work in overseas positions as a pre-requisite for senior leadership positions as global opportunities account for the majority of such firms' long-term growth, the report states. It adds one more contributing factor for skilled migration is that many large high-tech companies send recruiting teams to engineering schools in India, China and other developing countries, given the large number of students graduating in these countries. The possible outcome of this is rise of global collaborative teams for inventive work which is reflected in the number of patent filings.

Implications of talent flows

Global integration is generating ever-greater returns for matching talent with the right job or opportunity, the report states and adds that the global talent flows have profound implications cutting across business to politics to religion to culture to entertainment.

The report states that location/agglomeration plays an important role towards enhancing productivity of skilled migrants and is a critical step towards connecting talent flows to higher worldwide productivities. High skilled immigrants boost innovation and productivity in destination countries mainly through increased quantity of skilled individuals pursuing innovative work. Skilled migrants serve as effective channels for several forms of multi-directional exchange in a networked world, including trade, foreign direct investment, finance, knowledge, technology, cultural norms and political views. Terms like "brain drain" and "brain gain" are now used to label settings where the gains to the sending country from migration fall short of or exceed the costs, respectively.

Policies and Gatekeepers

Countries however restrict migration due to a number of factors including political, cultural and even philosophical. The primary argument in favor of restriction on high skilled migration revolves around the possible adverse wage and employment effects on skilled native workers. Two more arguments for restricting migration are to limit the volatility of migration flows that might impact the cyclical labor markets and national security concerns, therefore restricting employment of high skilled immigrants in certain key industries or with certain sensitive technologies.

The report however mentions that advocates in favor of flexible migration policies for high-skilled labor believe that native workers can benefit from skilled immigrants through complementary skills, agglomeration effects or labor demand arising due to immigrant entrepreneurship and innovation.

Policy approaches for selection of high-skilled people

The report further cites that while there are two broad policy approaches adopted by countries to select high skilled individuals, most countries display elements of both.

<u>The points or merit based approach</u> is the first approach which is also referred to as supply side policies to migration as it focuses on screening of individual applicants for admission.

It selects individuals based upon their observable education, language skills, work experience, and existing employment arrangements.

This approach does lead to a stable immigration process over times; however it does have disadvantages such as multi-year queues and possibility of talented migrants finding themselves underemployed due to lack of demand for their skills. Canada and Australia implement points-based systems for skilled migration.

Employer driven system or a demand-side approach is the second one as it places emphasis on firms selecting workers to be admitted into the country. Here labor markets, via employers, play a more direct role in determining the level and composition of skilled migration flows. The author has cited the example of the US using this approach. A distinct advantage of this approach over the points-based approach is that employers choose whom they want and immigrants get a job upon arrival. However this approach can also lead to certain disadvantages, like firms could use the program for purposes that are not in line with the intentions of the government; demand for visas under the employer-driven programs can show high volatility and under this approach, migrant is more tied to the sponsoring firm and may be in a weak negotiating position.

There appears to be an overall shift towards demand-driven elements and away from pure points-based programs.

In practice however, it has been observed that in case of talented foreign citizens, a number of countries not only remove restrictive visa regimes, but implement recruiting programs as well to attract such talents. For instance in Chile, foreign entrepreneurs are paid for the country's Start-up Chile program, whereby the companies are requested to spend six months in the country as an effort to build global skill connections and a mini-Chilean "diaspora."

Conclusions

The World Bank paper concludes that skilled migration and integration of global labor markets for high skilled occupations are likely to continue to move ahead in future, even though there are suggestions that video conferencing, on-line labor markets, and other uses of communication technology can mitigate the need for physical proximity and hence the need for talent flows. Evidences suggest that the new tools complement global movements instead of substituting them. The report also adds that while the overall migration patterns are expected to remain similar, the globalization of economic ties could lead to a rise in shorter-term and circular migration patterns for skilled labor, whereby migrants may return to their origin country after a few years.

The full report can be accessed at
http://documents.worldbank.org/curated/en/793861475694096298/pdf/WPS7852.pdf

Strategic Investment Funds - Opportunities and Challenges

Introduction

There has been a significant increase in the number of government sponsored Strategic Investment Funds (SIFs) or sovereign funds that have been introduced globally over the past 15 years across countries at all income levels. These funds combine financial objectives (generating returns for investors) with wider development considerations (catalysing capital flows to priority sectors) of national and regional economies. Thus, SIFs not only provide the much required public capital needed for development work, but some of the well managed SIFs also create opportunities for attracting private capital besides deepening domestic capital markets, and building the capacity of governments to act as professional long term investors.

However, establishment and operation of SIFs involve a number of challenges as it requires superior fund management skills while maintaining independence and transparency. Successful SIFs need to balance both policy and commercial objectives well. In a recently published paper – 'Strategic Investment Funds - Opportunities and Challenges', the World Bank has studied some of the SIFs closely to understand the factors responsible for the recent rise in SIFs, the challenges faced by these funds, and offers some of the possible solutions to address these issues.

Classification of SIFs and their Investment Strategy

World Bank in its report defines SIFs as special purpose investment funds that exhibit all of the following four characteristics:

1. Are sponsored and/or fully or partly capitalized by a government, by several governments, or by government-owned global or regional finance institutions;
2. Invest to achieve financial as well as economic returns, in accordance with a double bottomline objective;
3. Operate as expert investors on behalf of their sponsors; and
4. Provide long-term capital, primarily as equity. But may also invest in quasi-equity or debt.

It has been observed that investments of SIFs largely focus on infrastructure projects and/or infrastructure funds, while sometimes the investments are also made in private equity (PE) and venture capital (VC) funds for small and medium enterprises (SMEs). In terms of their overall investment strategy, notwithstanding their diversity, all SIFs aim to 'crowd in' private capital by serving as a cornerstone investor (as defined by Clark and Monk -2015). Within this broad operating environment, SIFs follow three types of policy objectives - catalytic, reinforcing, or financializing. The paper further adds that financialization and reinforcing are the most common strategies followed by the SIFs as has been observed during the analysis of SIFs, particularly in Emerging Markets and Developing Economies (EMDEs). On the other hand, SIFs that focus on climate financing appear to play a catalytic role independently of the country of operation.

Exhibit 1: Operational Strategies of Sovereign Development/Investment Funds

The report suggests that SIF's have multiple sources of funding, including balance of payment surpluses, official foreign currency operations, proceeds of privatization, pension reserves funds, fiscal surpluses, government (or government guaranteed) borrowing, and/or receipts resulting from commodity exports.

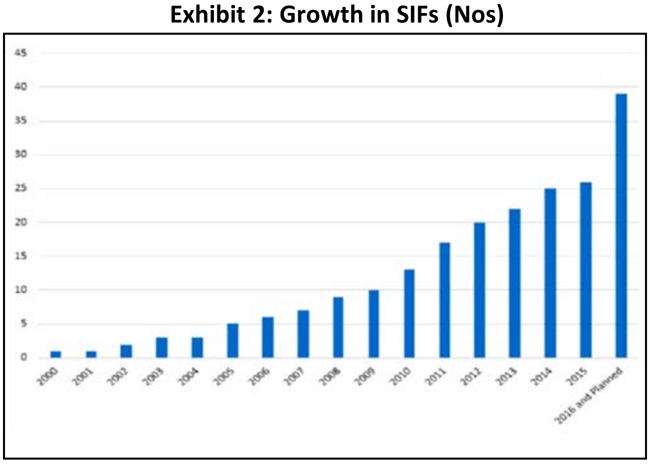
However, monetary authorities' foreign reserves held for balance of payment purposes, government employees' pension funds, traditional public enterprise operations, and assets managed for the benefit of individuals are not sources of funding for SIFs.

SIFs adopt different approaches to fulfil its objective of development of local economies through direct investments while generating high level of private participation. Some SIFs invest only in the domestic economy. These funds are owned by both the public and private sector, while others could be wholly owned by a government. On the other hand, there are some SIFs which operate at global or regional scale, and may be funded by several governments. Some SIFs may also act as venture capital (VC) funds, and some SIFs may also be thematic investors. For instance, in the area of clean energy finance, several SIFs have been established with the objective of attracting private investment in wind, solar and thermal energy infrastructure and energy efficiency. The report states that some climate SIFs are funded by multilateral financial institutions and green SIFs are emerging at national level too.

Factors leading to growth of SIFs

The World Bank in its report states that over the past 15 years, at least 26 SIFs have been established, and another 13 are planned. It adds that while there are numerous factors affecting the establishment of a SIF, the widening of the financing gap that has followed the 2008 financial crisis is likely to be one of them as 17 of the 26 SIFs were established after 2008.

Exhibit 2: Growth in SIFs (Nos)



The report states that governments have also established SIFs to support domestic capital market, especially in emerging market and developing economies where local financial markets may lack the range of financial products or intermediaries required to sustain economic development, or the density of financial intermediaries may be too low to ensure effective competition between providers.

The increasing number of SIFs may be indicative of a growing confidence among their sponsors in the capacity of these funds to address market failures and economic externalities, the World Bank states in the report. It adds that SIFs' dual financial and economic objectives allow investments to be guided by market imperatives – measured in terms of financial rate of return – as well as higher order policy imperatives – measured in terms of the economic rate of return (ERR) or other parameters.

SIFs' Structure and Market Validation

The report further states that depending on the relative importance of market versus policy objectives of the SIFs, their structure may vary. It could be private management of public capital, through hybrid funds or fully state owned direct investment funds. In case of private management of public capital, either the government invests in a private fund on terms reflecting policy priorities, or a public entity shares risk as a limited partner in a public-private hybrid fund. In this model, investment decisions are made independently by the private sector general partner that manages the fund, while the overall investment policy is set by the fund's board that is usually dominated by limited partners.

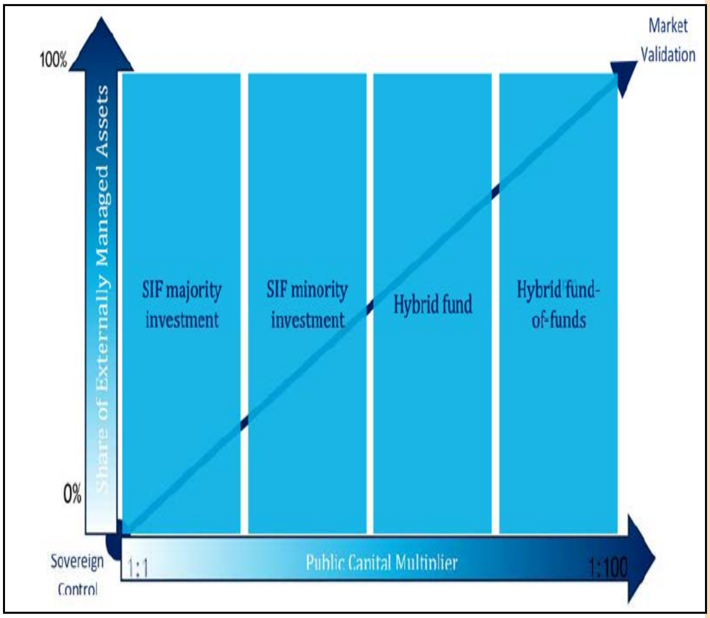
In funds that are fully government owned and/or operated, market validation may come from limitation on the ownership share in each investment, limiting the SIFs' investments to minority participation of a certain size. Except for hybrid funds, fund management is frequently provided by a government-owned fund management entity operating at arms-length from the government.

To assess the social and economic impact of an investment project, SIFs use various methods.

Funds in the clean energy space measures their policy achievements in terms of the amount of clean power generated while for some funds, main policy success benchmark is the amount of external investment unlocked by their guarantees for investment in the funds' defined priority sectors, with the aim to generate certain degree of multiplier on investments.

Investing with the private sector allows the public sector to generate a multiplier effect, which can range from 1:12 for a typical SIF's direct investment to 1:70 for a hybrid fund-of-funds, the report states. The size of a SIF's capital multipliers does not reflect its ability to operate efficiently, or the wider social economic impacts of its investment. But it does provide a measure of market validation, which is a critical success factor. The report states that while attaining a high level of private funding is a priority for SIFs, a higher multiplier may translate to less SIF control of policy objectives. In the fund-of-funds model, the public sponsor's control over an investee fund's investments may be limited to supervision of environmental, social, and governance (ESG) reporting, while direct investment funds can be expected to have a higher degree of control of policy objectives.

Exhibit 3: SIF structure, market validation, and public capital multiplier



Data analysis suggests that SIFs generate a wide range of public capital multipliers. Other things being equal, the size of the multiplier appears to be linked to a fund's structure and its investment strategy.

Common Challenge for SIFs

The research paper highlights that though SIFs are designed to achieve a wide range of policy objectives, some of which could be country and context specific, these funds face some common challenges. These include:

- ***Attracting private sector investment***

To attract private capital for a SIF, the SIF needs to be a credible investor. For many investors, corporate governance has become one of the key factors in their investment decision-making process. Hence, it is critical for SIFs to include robust corporate governance mechanisms in their establishing laws, bylaws and any other policy and procedures documents, and communicating these to investors. The paper adds that transparent and timely reporting of accounting information, and strong external audit systems contribute to increase the market credibility of a SIF.

The report further states that SIF's ability to attract private sector investment also varies as per the structure of the SIFs. Though hybrid funds provide a high degree of market validation, and are likely to generate a high overall multiplier and competitive financial returns. However, an external manager managing such funds may not have a natural incentive to achieve a high multiplier on SIF investments, since this is likely to result in more complex and time-consuming transactions that will not necessarily correspond to a higher return to the SIF's own share of the capital in a project. On the other side, in case of fully state-owned and/or managed SIFs, limiting the SIFs' investment to minority participation can provide the market validation of projects and enhance the integrity of investment decisions.

Investors' perception also gets influenced by the jurisdiction in which the fund is domiciled, based on which the integrity of the funds' activities is ascertained. Recognized international financial centers with strong legal, regulatory, and supervisory standards for fund operations could attract higher private capital by enhancing investors' confidence on such funds.

Further the paper states that when policy imperatives prevail over commercial considerations, SIFs may find it difficult to attract private capital even when they apply good corporate governance principles, and are domiciled in a country with good regulatory quality, rule of law, and overall institutional quality.

- ***Sourcing investable projects***

Sourcing investable projects may also be difficult, particularly where lack of capacity and information asymmetry hinder the preparation of a well-documented pipeline of bankable projects. The paper highlights that several EMDE governments are establishing infrastructure PPP project venture funds to accelerate the generation of project pipelines and the preparation and closure of PPP transactions. Sourcing projects from the national budget may provide the opportunity to align the SIF strategy to the development priorities of the country of operations, the report suggests. SIF's close relationship with the government makes it easier for these funds to source their projects from the national infrastructure (development) plan. Sourcing projects from National development plans and other government-related project pipelines must not hinder the ability of the SIF to make fully independent viable investment decisions that enable the SIF to attract private capital. This issue can be addressed by establishing a SIF as independent entity by an act of parliament.

- ***Balancing Policy and Commercial Objectives***

SIFs irrespective of their country of operations or area of investment, need to reconcile (and appropriately measure) policy and commercial objectives by achieving the competitive financial returns while delivering meaningful social and associated economic impact (returns).

SIFs use a simple approach: they assess investment opportunities that satisfy a financial return benchmark, against an economic benchmark often expressed as proxy measure of the project's economic and induced impacts, such as employment creation, the stimulation of new firms, the reduction in carbon emissions, and other proxy variables of their policy objectives. SIFs often operate within a confined investment universe, i.e. invest only in certain sectors, themes, or asset classes predefined by their owners.

- ***Securing the Right Staff***

Securing and retaining professional staff with the adequate knowledge and skills about generating value; with ability to read and interpret market trends and quickly act on them; and having access to an extensive network of contacts is necessary for SIFs to operate as expert investors, the report states. Co-investing with experienced private sector investors can provide the SIF with both market validation and additional expertise, to enhance the quality of investment decisions and fast track its staff's learning curve. A SIF's ability to establish staff remuneration policies outside of the public sector pay scale is also critical to attract and retain highly skilled investment managers, it adds.

Conclusion

World Bank in its paper suggests that properly structured and managed strategic investment funds can be effective vehicles for crowding in private investors to priority investments, thus magnifying the impact of public capital. It adds that their success rests on the fund's ability to balance policy and commercial objectives, source investment opportunities and secure right fund management activity.

The full report can be accessed at https://openknowledge.worldbank.org/handle/10986/25168

Indian Steel Sector

India emerged as the third largest producer of steel in the world in 2015, only behind China and Japan, and was projected to become the second largest producer by the end of 2016, though this seems to be difficult to achieve now as indicated by the latest production figures released by the World Steel Association. During January-November 2016, Indian crude steel production has reportedly grown at a healthy rate of 7.1% to 87.5 Million Tonnes (MT), while during the same period Japan's steel production has touched 96.06 MT. With this, the gap between India and Japan in terms of crude steel production has however narrowed to 8.5 MT, from a gap of 14.8 MT recorded in the corresponding period of the previous year.

In terms of steel consumption too, India is the third largest globally. Valued at over US$ 100 billion, the industry contributes about 2% to the country's GDP and provides employment to more than 6 lakh people. It is worth mentioning that in spite of decline in global steel consumption in 2015 with major steel producing countries witnessing production declines, India managed to record higher production level aided by higher domestic demand for steel during the year.

The World Steel Association expects the demand for finished steel in India to register a healthy 5.7% growth in 2017 (ref Table 1), amongst the highest in the world as compared to a meager 0.5% growth expected in world steel demand. Globally, demand for steel has been falling owing to slump in major economies like the European Union, the US, the UK & China among others, and is likely to remain subdued for some time in the future as well. While in India demand for steel is expected to grow on the back of consumption-boosting reforms and investments in infrastructure. Keeping pace with the expected increase in demand for steel in the country, India targets to increase production capacity and crude steel production to 300 MT and 275 MT respectively by 2025-26.

Factors aiding growth of the industry

A number of factors have supported the growth of the Indian steel industry and helped it attain a

Table 1: India's position in Global Steel industry

Country	Crude steel production (MT) (2015)	Apparent steel use per capita (kgs) of finished steel products (2015)	Growth forecast for finished steel demand (%) (2017)
China	803.8	488.6	-2.0
Japan	105.2	497.3	1.4
India	89.4	60.6	5.7
World	**1620.9**	**208.2**	**0.5**

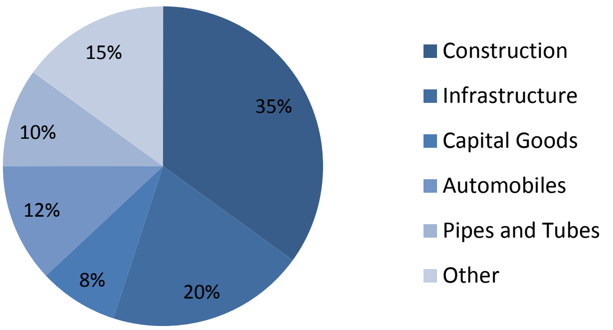
Source: World Steel Association

a significant position in the global steel industry.

The most noteworthy among these have been the establishment of new state-of-the-art steel mills along with continuous modernization and upgradation of older plants in the country; improvement in the energy efficiency of steel producing plants; backward integration and acquisition of global scale capacities by players, amongst others.

In recent years, however, the growth has largely been driven by the higher demand emanating from end-user sectors such as infrastructure, capital goods, real estate, automobiles, and consumer durables. Construction and infrastructure sectors together account for more than half of the total steel demand in the country, and automobiles sector accounts for 12% of the total consumption.

Chart 1: Steel consumption pattern in India



Source: FICCI

Besides a healthy growth in demand, the steel sector has also observed growth due to favorable government policies and higher (increasing) investments made by both domestic and foreign players in the Indian steel industry.

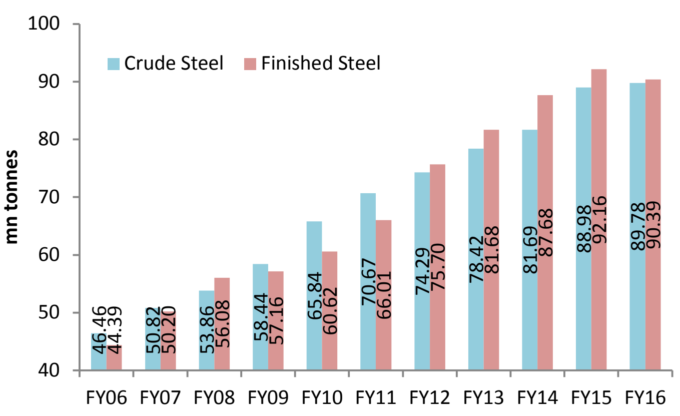
Backed by these enabling factors, both capacity as well as production of steel in the country has seen a steady growth. Steel production in the country, both crude as well as finished steel has in fact doubled over the last ten years as can be seen from the graph given below. In 2015-16, while crude steel capacity stood at 121.97 MT (growth of 11%), crude steel and finished steel production were recorded to be 89.79 MT and 90.98 MT, respectively.

During the ten year period from FY06 and FY16, while crude steel production has shown a steady increase, production of finished steel witnessed a slight dip in FY16 mainly because of inadequate availability of raw material and higher imports.

However, during April-October 2016, both crude steel and finished steel production has recorded higher growth of 8.2% and 10.9% over the corresponding period of FY16 and touched 56.2 MT and 57.7 MT respectively. SAIL and Tata Steel have remained the two major producers of crude steel in the country accounting for around 16% and 11.2% respectively in 2015-16. The country also met about 14% of its demand through imports in 2015-16.

Impetus on infrastructural development in the country, and government's mega initiatives such as 'Smart Cities, 'Make in India' etc. are all expected to continue to boost steel demand and hence production in the coming years as well.

Chart 2: Production trends (MT)



Source: CMIE

Table 2: Finished Steel – Supply Trends (MT)

	Production	Imports	Total Supply	Exports
2011-12	75.70	6.86	82.56	4.59
2012-13	81.68	7.93	89.60	5.37
2013-14	87.68	5.45	93.13	5.99
2014-15	92.16	9.32	101.48	5.60
2015-16	90.39	11.71	102.10	4.08

Source: JPC & CMIE

Challenges

While the sector has seen significant growth over a period of time, but it faces some challenges as well such as increasing threat from imports, raw material scarcity, infrastructure/logistics constraints, capital and financial issues.

Threat from imports

The oversupply in the global market given the slower demand and overcapacity (of about 650-700 MT) has led to a glut in the steel market and led to imports of finished steel into India rising sharply in the last two fiscals. China has been witnessing lower domestic demand and has been exporting steel at low prices to other countries. This is evident from the trend in imports from China into India which shot up to 4.0 MT in 2015-16 from 1.1 MT in 2013-14 and it remains one of the most imminent threats for Indian steel industry presently. In addition, India has Free Trade Agreements with Japan and Korea under CEPA, as a result of which import duty for steel from these countries is lower compared to other countries. Due to such FTAs, steel imports from South Korea and Japan have increased by 52% and 25% respectively in 2015-16 over the previous year. During 2014-15 and 2015-16, China, Japan and Korea accounted for around 76% of steel imports into India.

Government over the last one year has undertaken measures to check imports of steel and protect the domestic steel industry, which includes imposition of safeguard duty, levy of anti-dumping duties on specified products (on evidence of dumping of steel products from countries include China, Japan, Korea amongst others), Minimum Import Price (MIP) for certain products. Going forward, there is a need to monitor the requisite anti-dumping and safeguard duties closely.

As a result of these protective measures undertaken by the government, finished steel imports have shown a decline of about 40% during April-October 2016 to 4.1 MT.

However, even though levying of duties help in controlling imports to a large extent, they cannot be perceived as a long term solution. Instead steel makers would have to look for ways to enhance competitiveness in the global market to keep the industry's position strong. It is also worth noticing that both Japan and South Korea have been requesting India to remove restrictions on steel imports, which sooner or later, India will have to honor.

Raw material constraints/security

The industry also faces a challenge with respect to adequate availability of critical raw materials such as iron ore and coal. Developments in India's mining sector (iron ore and coal) have in fact turned the steel industry's competitive advantage to a major constraint. There have been multiple occasions of major iron ore mining states imposing bans on mining in the past. Though these restrictions were relaxed later on, but the move had an adverse impact on the production of steel in the country.

The coal industry too has not been able to meet the requirement of the steel sector as India is deficient in coking coal, which is among the important raw materials used for steel production; (coal is primarily used as a solid fuel to produce electricity and heat through combustion). This has increased the dependence of Indian steel companies on imports to meet their coal requirements. Companies in an attempt to secure raw material supplies have also acquired overseas raw material assets. Rising coal prices in international markets raise concerns of higher production costs.

Regulatory constraints/bottlenecks

The Indian steel industry has been supported by favorable regulatory policy measures which include tax incentives, tariff protection measures, financing, amongst others. Still, the sector faces various challenges related to land acquisitions, mining leases, delays in obtaining environmental and forest clearances, relief and rehabilitation policies, etc., which has prompted several players including major players to shelve their steel projects involving significant capacity additions.

Logistics constraints

The other big problem that the industry faces is the inadequate infrastructure and logistics facilities of the country. Steel manufacturing involves bulk movement of both raw materials and finished products over long distance and across the country. Most of the steel plants are therefore located closer to the resource locations. In India, raw materials resources and its extraction is largely confined to remote (relatively inaccessible) areas in the Eastern and Southern regions of the country, which are characterized by poor transport and logistics network and power shortages.

These infrastructural constraints adversely impact the Indian steel industry's competitiveness on account of higher transportation cost, higher tariffs, and long delays. The cost of steel transportation and associated raw materials via road is around four times expensive than waterways and twice that of railways.

Currently, roads account for around 55-60% of transport mode for the steel industry, efforts and measures need to be taken to provide adequate/proper linkages with respect to railways, ports, roads and waterways for movement of both raw material (to plants) and finished products (to markets).

Table 3: Share of different modes of transport in Indian Steel Industry

	India	China	US
Road	55-60%	20-25%	35-40%
Rail	36%	28-33%	48-52%
Water	6%	47%	12%

Source: NITI Aayog

The government has undertaken the port-led development under the Sagarmala project and it is expected that top steel companies would be able to transfer around 40% of their freight movement to the coastal shipping route, which could ease the situation.

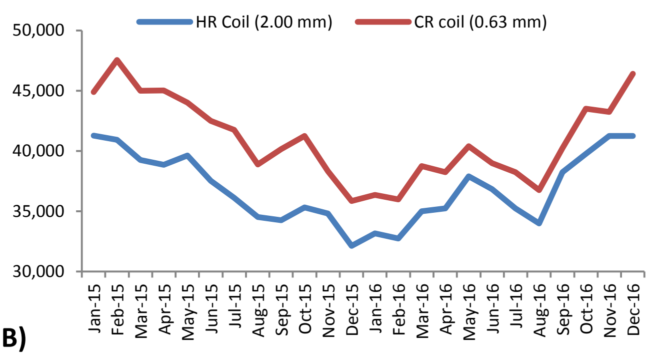
Financial Issues

Over the past few years, multiple factors such as lower capacity utilization rates, higher raw material prices (coking coal, iron ore, etc.), rising transportation cost and increasing imports, have adversely impacted the financial health of the steel industry.

Though steel capacity in India has increased rapidly, production has been low as mentioned earlier. As a result, capacity utilization level has seen a reduction from a high level of around 90% in FY08 to about 75% in recent years. Price and sales realization of the capital intensive steel industry has also taken a beating; (prices of steel products had remained subdued since FY14 due to lower global demand, though they have started recovering in the later part of 2016 due to increase in raw materials and revival of demand). Consequently, the industry has accumulated huge debts over the years and is finding it difficult to service these debts. Owing to better future prospects for the industry, the players are planning to enhance capacity and would require long-term finance. Measures need to be adopted to improve the financial health of the steel industry and enable it to cater to the domestic as well as global demand as and when it picks up.

Chart 3: Steel prices in Delhi (Rs/tonne)

A)



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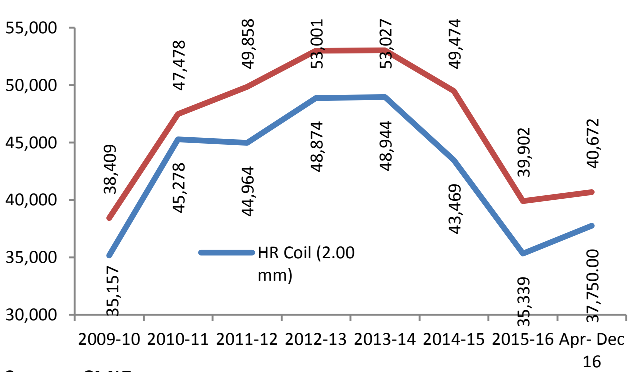


Source: CMIE

Declining Competitiveness of Indian Steel Manufacturers

Over the past few years, owing to several factors, the competitiveness of the Indian steel industry has come down substantially. These factors include import duty and cess levied on coal – the primary raw material; royalty imposed on iron ore; higher transportation costs; higher industrial power tariffs, etc. It is estimated that these cost elements increase the overall production cost of steel in India from around US$ 320-340 per tonne to around US$ 420 per tonne.

Table 4: Cost disadvantage of Indian Steel Industry (US$/tonne)

Parameter	Cost
Logistics & Infrastructure	25-30
Power	8-12
Import duty on coal	5-7
Clean energy cess	2-4
Taxes & duties on Iron ore	8-12
Finance	30-35
Total cost disadvantage	**80-100**

Source: NITI Aayog

Government initiatives

Government has been taking various initiatives to provide all round support to the sector and help the sector overcome the challenges that it confronts. It has taken steps to boost the country's steel capacity further. These include establishing Special Purpose Vehicles (SPVs) with Karnataka, Orissa and Jharkhand (iron ore rich state) to set up 3-6 MT per annum steel plants; making investment in modernization and expansion of steel plants of SAIL (12.8 to 21.4 mtpa) and Rashtriya Ispat Nigam (3.0 mtpa to 6.3 mtpa). The Ministry of Steel has evolved the concept of Ultra Mega Steel Plants to enable the industry achieve the targeted production capacity of 300 MT by 2025-26. SAIL is participating for setting up of an Ultra Mega Steel Plant of capacity (3 mtpa + 3 mtpa) or (4 mtpa +2mtpa) in Bastar, Chhattisgarh. SAIL further plans to expand its capacity to 50 mtpa by 2025. The government has also done away with the categorization of steel makers/producers as primary, secondary, major, minor, others and brought all of them under one platform . This is expected to offer equal opportunities for all players to participate in government projects.

In addition to becoming among the largest producer, the government wants India to be a quality steel maker. To this effect it has brought several steel products under the purview of the BIS to raise (and standardize) their quality standards. The Stainless Steel Products (Quality Control) Order, 2016 issued on 10th June, 2016, covers three stainless steel products. Subsequently, the government has brought more steel grades under the order. To spearhead research and development activities in the sector, the government has also set up the Steel Research and Technology Mission of India with an initial corpus of Rs. 200 crore.

The government has brought out amendments to the Mines and Minerals Development Regulation Act and has launched the National Mineral Exploration Policy which is expected to augment the raw material availability. The government has also given approval for a joint-venture between Metal Scrap Trade Corporation (MSTC) and Mahindra Intertrade for setting up India's first Greenfield auto shredding and recycling facility, which will aide in saving of foreign currency, as a result of import substitution of scrap, a raw material for steel production.

Future Outlook

With these efforts in place, the government is hopeful of making India the second largest steel producer in the world. Both global as well as domestic demand is expected to increase in future, providing the necessary fillip to India's steel production. Though India is among the top steel consuming countries in the world, it still lags behind other major steel producing countries in terms of steel usage in overall economic activities or per capita consumption of steel which is around 63 kgs in India (2015-16). India therefore holds huge potential for improvement in steel consumption, especially since the per capita consumption in the rural areas is much lower at around 10 kgs. The government aims to double India's per capita steel consumption to 120 kgs by 2020, supported by higher demand from construction, railways and other steel-intensive sectors. To facilitate sale of finished and semi-finished steel products in the country, the government has launched e-platform and 'MSTC Metal Mandi' jointly by Metal Scrap Trade Corporation and the Ministry of Steel.

Thus it is clear that India's steel industry has enormous potential for growth owing to comparatively low per capita consumption level and government's thrust on infrastructure and manufacturing in India which will create demand for steel. The sectors that have the potential to increase steel consumption include automobiles, packaging, irrigation, water supply, engineering and capital goods, real estate and transportation, amongst others. However, there are concerns on this front on account of weak investments by the private sector and the effects of demonetization which has impacted the construction and real estate sectors in the near term.

While there is immense potential for growth, appropriate and timely measures need to be taken to address the challenges confronting the industry. This would also enable it improve its global competitiveness and garner a greater share of the global steel market.

Economy Fact Sheet – GDP

FICCI

GDP growth for 2016-17 estimated at 7.1 percent

- *As per the first advanced estimates released by the Central Statistics Office, Gross Domestic Product is expected to grow by 7.1 percent in 2016-17 vis-à-vis 7.6 percent growth recorded in the previous fiscal year. Likewise, Gross Value Added is estimated to grow at 7.0 percent in 2016-17 vis-à-vis 7.2 percent growth noted in the previous fiscal year.*

- *As per sectoral classification, agriculture and allied services is the only sector which is projected to grow at a higher rate of 4.1 percent in 2016-17 as against 1.3 percent growth reported in 2015-16. Conversely, growth in industry is anticipated at 5.2 percent in 2016-17 as against 7.4 percent growth reported in 2015-16. Growth of services is also estimated to moderate to 8.8 percent in 2016-17 as against 8.9 percent growth reported in the previous fiscal year.*

- *On the expenditure side, gross fixed capital formation is projected to contract by 0.2 percent in 2016-17 as compared to a growth of 3.9 percent recorded in the previous fiscal. Growth of private final consumption expenditure is expected to moderate to 6.5 percent in 2016-17 as against 7.5 percent in the previous year. Government final consumption expenditure, however, is projected to grow by a massive 23.8 percent in 2016-17 vis-à-vis 2.2 percent growth in 2015-16.*

First Advanced Estimates (% Y-o-Y)

	2014-15	2015-16	2016-17
GDP	7.2	7.6	**7.1**
GVA at basic prices	7.1	7.2	**7.0**
Agriculture, forestry & fishing	-0.3	1.3	**4.1**
Industry	5.9	7.4	**5.2**
Manufacturing	5.5	9.3	**7.4**
Services	10.3	8.9	**8.8**
PFCE	6.2	7.5	**6.5**
GFCE	12.8	2.2	**23.8**
GFCF	4.9	3.9	**-0.2**

Quarterly Growth in GVA and its Components (% Y-o-Y)

	2015-16		2016-17	
	Q1	Q2	Q1	Q2
GDP	7.5	7.6	7.1	7.3
GVA	7.2	7.3	7.3	7.1
Industry	6.7	6.3	6	5.2
Manufacturing	7.3	9.2	9.1	7.1
Services	8.8	9	9.6	8.9
PFCE	6.9	6.3	6.7	7.6
GFCE	-0.2	3.3	18.8	15.3
GFCF	7.1	9.7	-3.1	-5.6

The Reserve Bank of India (RBI) downwardly revised India's GVA growth projection in its latest assessment of the economy. The RBI now forecasts GVA to grow by 7.1 percent for the entire fiscal 2016-17 as compared to 7.6 percent growth forecasted earlier.

Likewise, Asian Development Bank (ADB) revised India's GDP growth projection to 7.0 percent for the year 2016-17, down from 7.4 percent projected earlier. ADB feels that India's recent move to demonetize high currency notes is likely to dampen growth in the current fiscal. Weak private investments were also cited as a cause of concern. ADB, however, retained India's GDP growth projection at 7.8 percent for the next fiscal year. World Bank and IMF, too, have downwardly revised India's growth prospects for the year 2016 in their latest report.

GDP Growth Projections (% YoY)

	2015	2016	2017
OECD (November 2016)	7.6	7.4	7.6
Asian Development Bank (December 2016)	7.6	7.0	7.8
World Bank (January 2017)	7.6	7.0	7.6
International Monetary Fund (January 2017)	7.6	6.6	7.2

Agriculture sector witnessed improved growth numbers on the back of a better monsoon season which bodes well for the rural economy. However, the slow growth in industry and contraction in gross fixed capital formation remains a worrisome factor. The momentum in the capex cycle remains elusive and kick starting the domestic investment cycle is the need of the hour.

We hope that the government will continue to undertake reforms to propel growth and expect various demand and investment stimulating measures in the forthcoming Union Budget 2017-18.

Source: MOSPI, RBI, Economic Outlook, CMIE, IMF, World Bank, ADB, OECD and FICCI Research

Economy Fact Sheet – Balance of Payments

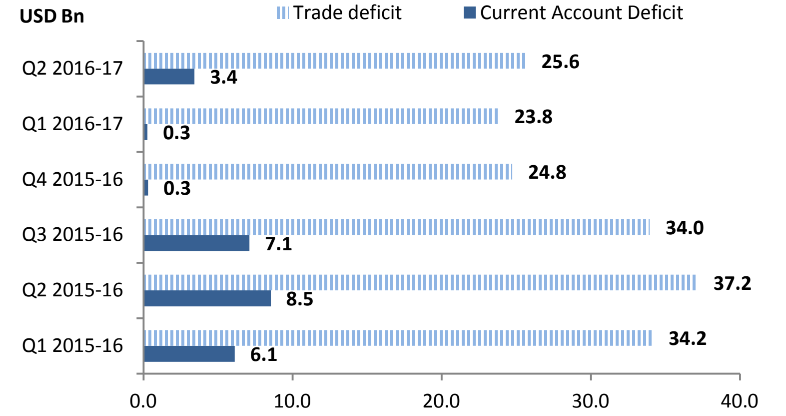
CAD stood at 0.6 percent of GDP in Q2 FY17

- *India's Current Account Deficit (CAD) narrowed to USD 3.4 billion in Q2 2016-17 as compared to USD 8.5 billion in Q2 2015-16. As a percent of GDP, CAD stood at 0.6 percent in Q2 2016-17 as against 1.7 percent noticed in Q2 2015-16.*

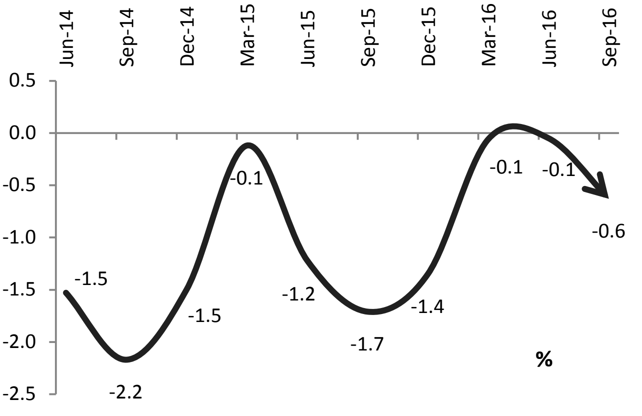
- *Net foreign direct investment gathered pace and stood at USD 17.2 billion in Q2 of 2016-17. This was significantly higher than USD 6.5 billion reported in Q2 of 2015-16. Portfolio investments also noted an improvement during the quarter. Inflows were reported at USD 6.1 billion at the end of Q2 2016-17 as compared to an outflow equivalent to USD 3.5 billion noted in the corresponding quarter of previous fiscal year.*

- *At the end of the second quarter of 2016-17, foreign exchange reserves stood at an all time high of USD 372.0 billion. Reserves increased by USD 8.5 billion in Q2 of 2016-17 (on a BoP basis) as compared with a decline of USD 0.9 billion in Q2 of 2015-16. However, as of November 2016, foreign exchange reserves stood at USD 361.1 billion.*

Snapshot of trends in India's Current Account Balance



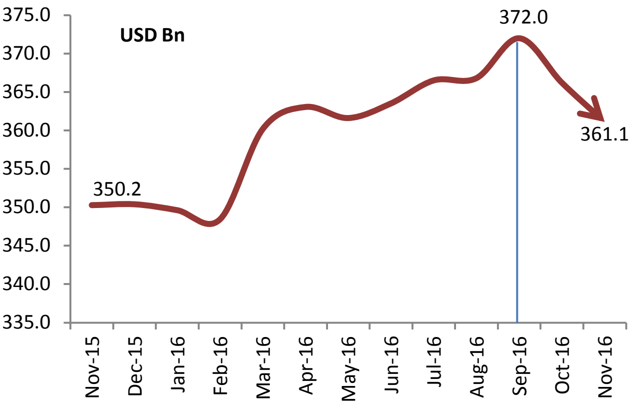
Current account as % to GDP (base year 2011-12)



Balance of Payments- Key Indicators

USD Billion	Q1 FY16	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17	Q2 FY17
Current account	-6.1	-8.5	-7.1	-0.3	-0.3	-3.4
Goods	-34.2	-37.2	-34.0	-24.8	-23.8	-25.6
Services	17.8	17.8	18.0	16.1	15.8	16.3
Foreign Direct Investments	10.0	6.5	10.7	8.8	4.1	17.2
Foreign Portfolio Investments	-0.1	-3.5	0.6	-1.5	2.1	6.1

Forex Reserves



Trade deficit declined to USD 25.6 billion in Q2 2016-17 as compared to USD 37.2 billion reported in the corresponding period previous year, which has led to a decline in current account deficit. However, fall in the earnings from software, financial services and charges for intellectual property rights caused moderation in net services receipt. Private transfer receipts also declined by 10.7 percent in Q2 2016-17 vis-à-vis the corresponding period the previous year. Workers remittances, which form the major part of private transfers, fell to USD 9.1 billion in Q2 2016-17 vis-à-vis USD 10.3 billion in Q2 last year.

While oil prices are expected to rise in the near future, owing to cut in production by OPEC countries, current account deficit is expected to remain at manageable levels due to expected pick up in exports, going forward. Additionally, higher FDI inflows and there adequate forex reserves provide the cushion against any contingency.

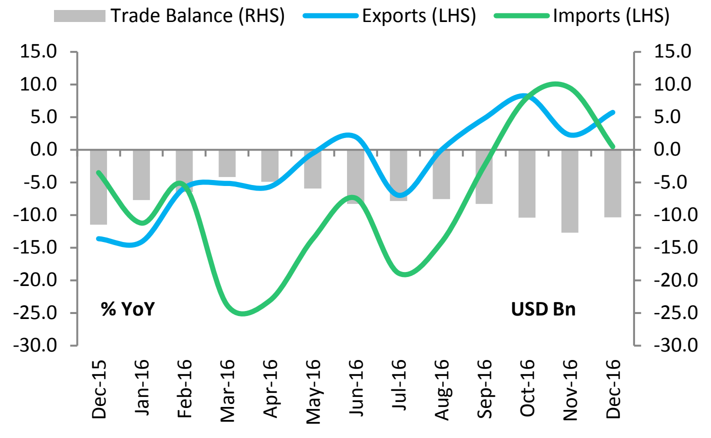
Source: RBI, Economic Outlook CMIE

Economy Fact Sheet – Foreign Trade

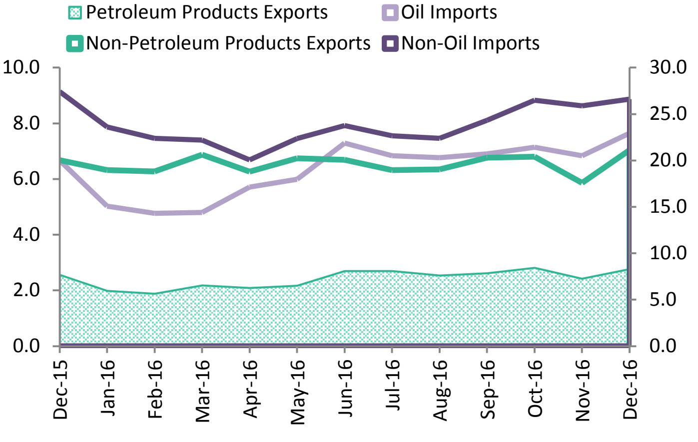
Trade deficit stood at USD 10.4 billion in December 2016

- *India's trade deficit stood at USD 10.4 billion in December 2016 vis-à-vis USD 11.5 billion in December 2015.*
- *Total merchandise exports registered a growth of 5.7 percent in the month of December 2016 as compared to a decline of 13.6 percent noted in the same month previous year. In terms of value, merchandise exports stood at USD 23.9 billion in December 2016. Exports of petroleum products witnessed a growth of 8.2 percent while non-petroleum products exports reported 5.4 percent growth during the month.*
- *Overall imports for the month of December 2016 stood at USD 34.3 billion, which is 0.5 percent higher than USD 34.1 billion worth of imports in December 2015. Oil imports witnessed a growth of 14.6 percent while non-oil imports contracted by 3.0 percent during the month. Gold imports were seen contracting by 48.5 percent in December 2016 as against a growth of 179.1 percent noted in the corresponding month previous year.*

Trend in India's Merchandise Trade



Oil- Non Oil Trade (in USD Billion)

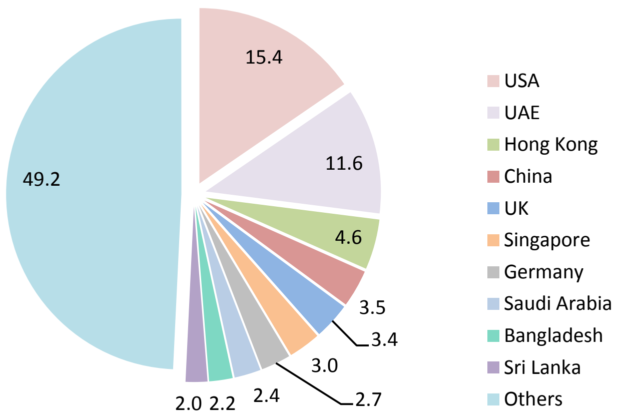


December was the fourth consecutive month when merchandise exports reported growth. The recovery in exports has been broad based with most of the major export commodities (such as engineering goods, drugs & pharmaceuticals, gems & jewellery, petroleum products and marine products) registering growth in December 2016.

In 2015-16, the top six export items accounted for around three fourths of India's export basket. In addition, the top ten export destinations constituted for more than half of India's outbound shipments. However, given the recent political developments influencing trade and investments scenario, there is a growing need for India to further diversify its export basket as well as export markets.

It has become necessary to work on measures to enhance India's competitiveness in the global market. The forthcoming Union Budget can include measures to boost the exports performance of MSME sector, especially through additional benefits for marketing and financial assistance.

India's Top Ten Export Destinations in 2015-16



Top Six Export Items in 2015-16	% Share
Engineering goods	21.9
Gems & jewellery	15.1
Chemicals & related products	12.5
Petroleum products	11.6
Textiles (excluding RMG)	6.5
Readymade garments (RMG)	6.5

Source: Ministry of Commerce and Industry, Economic outlook CMIE and FICCI Research

Economy Fact Sheet – Index of Industrial Production

IIP grew by 5.7 percent in November 2016

- *Index of Industrial Production reported a thirteen month high growth of 5.7 percent in November 2016. The improved growth numbers during the month has led to 0.4 percent growth over the cumulative period in April-November 2016 as against a contraction of 0.3 percent noted during April-October 2016.*

- *Index for manufacturing sector registered 5.5 percent growth in November 2016 as compared to (-) 2.4 percent growth registered in the previous month. Mining activity witnessed a five month high growth of 3.9 percent in November 2016. Generation of electricity also reported strong growth of 8.9 percent in November 2016. This was the highest growth reported in the past seven months.*

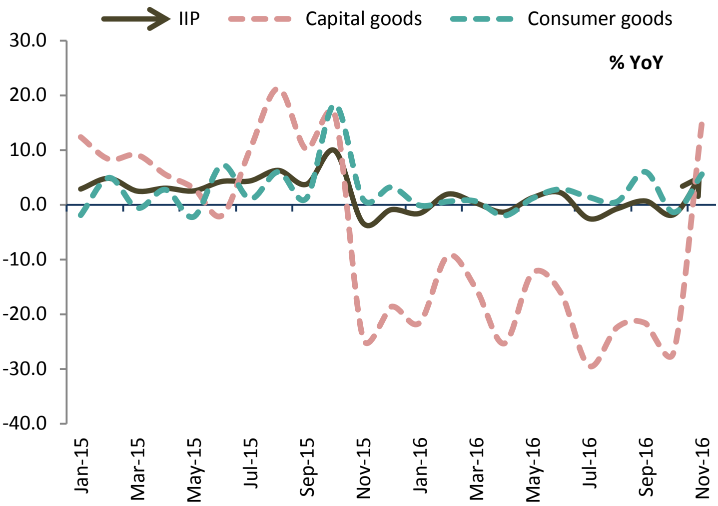
- *As per use based classification of industrial production, basic goods noted 4.7 percent growth in November 2016 as compared to 4.2 percent growth noted in the previous month. Intermediate goods recorded 2.7 percent growth in November 2016. Growth in capital goods resurfaced, with the index growing 15.0 percent in November 2016, after contracting for twelve consecutive months.*

- *Consumer goods grew by 5.6 percent in November 2016. Both consumer durables (9.8 percent) as well as consumer non-durables (2.9 percent) witnessed an improvement in growth during the month.*

Industrial Performance- Monthly (% Y-o-Y)

% growth rate	Nov-15	Aug-16	Sep-16	Oct-16	Nov-16
Index of Industrial Production	-3.4	-0.7	0.7	-1.8	5.7
Sectoral					
Mining	1.7	-5.9	-3.2	-0.7	3.9
Manufacturing	-4.6	-0.3	0.9	-2.4	5.5
Electricity	0.8	0.1	2.4	1.1	8.9
Use-Base Classification					
Basic goods	-0.5	3.5	3.9	4.2	4.7
Capital goods	-24.4	-22.4	-21.6	-26.9	15.0
Intermediate goods	-1.5	3.3	2.1	2.7	2.7
Consumer durables	12.2	2.1	13.9	0.6	9.8
Consumer non-durables	-4.9	-0.5	0.1	-2.9	2.9

Trend in IIP, Capital Goods and Consumer Goods Growth



- Data on industrial production reported an upsurge in manufacturing activity in the month of November 2016. This is in line with the latest edition of FICCI's Manufacturing Survey which had projected better outlook for manufacturing in the October-December 2016 quarter.

- Several banks have recently announced a reduction in lending rates which is expected to have a positive impact on manufacturing growth in coming months. Both consumption & investment demand are anticipated to increase, going forward. While this bodes well for industrial growth, it is important to sustain the momentum created. We, therefore, look forward to an accommodative stance by the RBI in its forthcoming monetary policy.

FICCI's Manufacturing Survey- December 2016

Quarter	% of Respondents Expecting Higher Production
Q-3 (2016-17)	63%
Q-2 (2016-17)	55%
Q-1 (2016-17)	53%
Q-4 (2015-16)	60%
Q-3 (2015-16)	55%
Q-2 (2015-16)	63%
Q-1 (2015-16)	44%

Source: MOSPI, Economic outlook CMIE and FICCI Research

FICCI – Economy Watch Team

- **Monika Dhole**
  Email: ***monika.dhole@ficci.com***

- **Pragati Srivastava**
  Email: ***pragati.srivastava@ficci.com***

- **Sakshi Arora**
  Email: ***sakshi.arora@ficci.com***

- **Meenakshi Srinivasan**
  Email: ***meenakshi.s@ficci.com***

- **Shreya Sharma**
  Email: ***shreya.sharma@ficci.com***