Economy Watch

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State of the Economy

The year 2017 has been positive so far for the global economy. Even though some downside risks continue to underline the broad global outlook, there are signs of growth regaining momentum. Economic prospects have strengthened for some advanced economies, while the outlook on emerging market economies remains mixed. According to IMF's latest World Economic Outlook Report released in April 2017, world output growth is estimated to pick up from 3.1% in 2016 to 3.5% in 2017 and 3.6% in 2018. World trade volume is also expected to see a rebound this year.

Commodity prices have been edging up which bodes well for the commodity exporting countries but the countries that rely on commodity imports will have to adjust to the increase in prices. The forthcoming OPEC meeting in May 2017 is being looked forward to with interest. Furthermore, the first round of election results in France yields optimism and has doused the probability of a 'Frexit' to some extent.

On the domestic front, the economy is seen moving on track. If the pace of implementation of reforms gathers further momentum and no major geo political tension shapes up, our economic growth could further accelerate.

The lead economic indicators such as passenger vehicle sales, PMI index, railway freight numbers, cellular subscriptions report an improvement.

Further, the recent state electoral results have sent a positive signal to the investor community. A surge has been noted in foreign portfolio investments inflows over the past couple of months. Rupee value vis-à-vis the USD has strengthened and is amongst the best performing currencies in Asia at present.

The Reserve Bank of India announced the first Bi-monthly Monetary Policy for 2017-18 on April 6, 2017. While there was no change in the repo rate; the policy rate corridor was narrowed by 25 bps and the statement cited using a mix of measures to tap excess liquidity as and when need arises. In addition, banks were allowed to invest in REITS and InvITs and this is likely to offer a good source of liquidity for the real estate companies.

Gross Domestic Product

The latest growth data indicates resilience and a steady overall performance. The Q3 2016-17 GDP numbers were robust despite the wide expectation of a slowdown with the impact of demonetization manifesting. The Q3 GDP growth was reported at 7.0% and projection for the full fiscal year 2016-17 was put at 7.1%.

The consumption activity, which was hit post demonetization, is also seen gaining strength. Private final consumption expenditure posted a surprising 10.1% growth in Q3 2016-17 y-o-y vis-à-vis 5.1% growth reported in Q2. The process of remonetisation is almost complete and will further drive demand going ahead. Growth was also supported by the increase in government final consumption expenditure.

In addition, gross fixed capital formation reported 3.5% growth in Q3 2016-17 after remaining in negative terrain for two consecutive quarters. Nonetheless, a more solid rebound in domestic capital formation will be imperative for sustaining growth at a higher level.

From economic activity side, the agricultural sector growth is seen picking up. While growth in the sector was reported at a strong 6.0% in Q3, the full year estimate is indicated at 4.4%. The normal monsoon in 2016 has been a boon for the agriculture sector. Kharif crop production was reported at a record high and Rabi production is also projected to be robust. A moderation is expected in industry and services sector growth in 2016-17.

Table 1: GDP growth (in %): Expenditure Side

	2016-17			2016-17
	Q1	Q2	Q3	
GDP	7.2	7.4	7.0	7.1
PFCE	7.2	5.1	10.1	7.2
GFCE	15.5	15.2	19.9	17.0
GFCF	-2.2	-5.3	3.5	0.6

Table 2: GVA growth (in %): Economic Activity

	2016-17			2016-17
	Q1	Q2	Q3	
GVA	6.9	6.7	6.6	6.7
Agriculture	1.9	3.8	6.0	4.4
Industry	6.1	5.1	6.6	5.8
Services	8.8	8.2	6.8	7.9

Reserve Bank of India in its latest policy assessment estimates GVA growth at 7.4% for the year 2017-18.

The monetary policy annual report alludes to a positive outlook for the year 2017-18 on the back of an anticipated increase in discretionary spending, positive measures announced in Union Budget 2017-18 and an improved outlook for global growth and trade in 2017 and 2018. As for the key risks, the possibility of looming El Nino can impact agricultural growth this year.

Index of Industrial Production (IIP)

Growth in index of industrial production (IIP) remains elusive to any firm signs of recovery. The overall IIP contracted by 1.2% y-o-y in the month of February 2017, vis-à-vis 3.3% y-o-y growth reported in January 2017.

As per economic activity wise classification of the index, moderation was noted in all three broad sub segments – with manufacturing sector growth reporting a drop by about 2.0%. Further, in eleven months up to February 2017 the IIP index registered negative growth in six months.

Likewise as per used based classification the sub segments indicate a weak performance. The capital goods segment after reporting a double digit growth of 10.9% in January 2017, once again slipped in to the negative zone in February. The capital goods sector recovery is yet to find a firm ground and this remains one of the key concerns at hand.

The domestic private investors remain apprehensive to undertake investments and the same has been indicated in FICCI surveys as well. Though capacity utilization rates have seen some improvement backed by a pick-up in demand; fresh investments are yet to come in.

Both intermediate and consumer goods segment noted a contraction as well during the month (February 2017).

Table 3: Industrial Performance- Monthly (% Y-o-Y)

% growth rate	Feb-16	Nov-16	Dec-16	Jan-17	Feb-17
Index of Industrial Production	1.9	5.7	-0.1	3.3	-1.2
Sectoral					
Mining	5.0	3.9	5.5	5.3	3.3
Manufacturing	0.6	5.4	-1.7	2.9	-1.9
Electricity	9.6	8.9	6.3	3.9	0.3
Use-base industry classification					
Basic goods	5.4	4.7	5.5	5.3	2.4
Capital goods	-9.3	14.3	-3.9	10.9	-3.4
Intermediate goods	4.9	2.4	-1.3	-1.9	-0.2
Consumer durables	10.4	9.4	-8.9	6.7	-0.9
Consumer non- durables	-4.8	2.5	-4.4	-3.0	-8.6

Source: CMIE

Both the Government and the Central Bank have taken a slew of measures over the past couple of years to check the lending rates. The Reserve Bank of India has revised down the repo rate by 175 bps between January 2015 and October 2016; the interest rates on small saving scheme were reset and marginal cost of funds based lending rate was made applicable last year. Earlier this year, following a surge in deposits some major banks did revise down their lending rates. Given this backdrop, in the latest round of FICCI's Business Confidence Survey the participants were asked to indicate if they have been able to actually benefit from the recent cut in lending rates by banks. According to survey results, about 67% of the participants indicated that they have not been able to benefit from the lending rate cut. Further, out of the remaining who said they have been able to benefit, the extent of benefit varied between 10 basis points to 200 basis points.

The latest survey results report that on an average the companies are paying an interest rate of about 11.0% on working capital loans and 11.3% on term loans.

Inflation

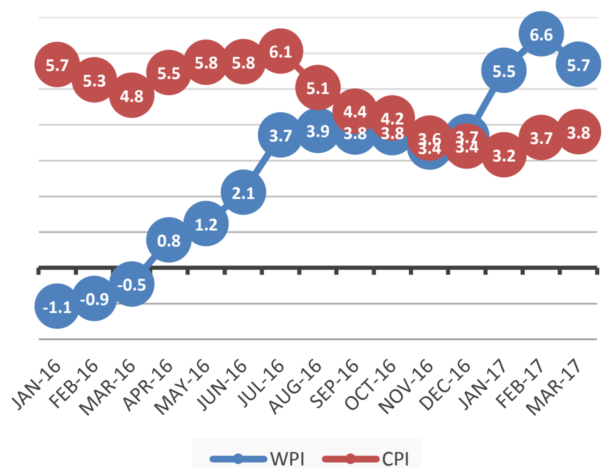
Both wholesale and retail prices remained benign for a large part of the fiscal year 2016-17. However, some pressure was seen emerging at the beginning of 2017 given the rise in crude oil and metal prices.

As per the latest available data, WPI based inflation was reported at 5.7% y-o-y in March 2017, vis-à-vis 6.6% y-o-y inflation rate in February 2017.

Food article prices edged up during the month led by an increase in fruits and vegetable prices. The effect of the seasonal factors and demonetisation based distress sales of fruits and vegetables is waning off causing an increase in prices. However, prices of pulses which have been a key contributor to the overall food inflation have begun to soften.

The supply side measures taken by the Government (zero import duty, increase in MSP and maintaining buffer stocks) have allowed the prices of pulses to settle. Prices of arhar and urad have dropped quite significantly and are ruling at below the MSP in states like Maharashtra, Madhya Pradesh, Gujarat and Karnataka.

Chart 1: Inflation Rate (in %)



Source: CMIE

In case of fuel and manufacturing segments, prices moderated a tad. However, despite the moderation, fuel prices witnessed double digit growth in February 2017 (18.2% y-o-y inflation rate).

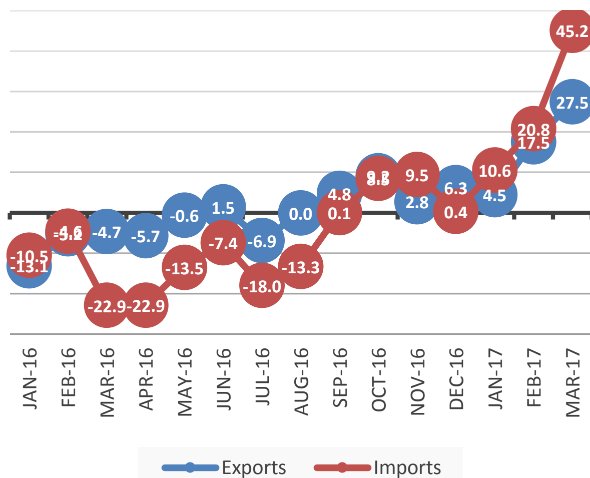
On a cumulative basis over the period April 2016-March 2017, whole sale based price inflation stood at 3.7% y-o-y, vis-à-vis (-) 2.5% y-o-y during April 2015- March 2016. With regard to CPI, the latest data point was reported at 3.8% y-o-y for the month of February 2017, vis-à-vis 3.7% y-o-y retail inflation observed in previous month.

The increase in case of CPI was more broad based with most of the sub segments reporting marginally higher prices during the month. The annual average CPI based inflation rate for 2016-17 was observed at 4.5%, vis-à-vis 4.9% inflation noted in 2015-16. Further, according to Reserve Bank's latest monetary policy review headline CPI is projected at 4.2% in Q1 & Q2 2017-18 and is expected to touch about 4.9% by the year end. The review cites persistence of upside risks to inflation on account of volatility in exchange rates, closing output gap, rising probability of El-Nino and one off effect of Goods & Services Tax.

Foreign Trade

A turnaround in India's foreign trade was seen at the end of the second quarter of 2016-17 and it is heartening to see the recovery holding on for India's merchandise exports and imports.

Chart 2: Export and Import Growth (in %)



Source: CMIE

The country's merchandise exports reported a growth of 27.5% y-o-y in March 2017 and stood at USD 29.2 billion in absolute terms; while imports registered 45.2% y-o-y growth and stood at USD 39.6 billion.

With regard to exports, both oil and non-oil exports noted an uptick during the month on y-o-y as well as m-o-m basis. Under manufacturing (which constitutes for about three fourth of our exports), engineering goods exports witnessed 46.6% y-o-y growth in March 2017. Gems and jewellery exports recorded 12.5% y-o-y growth while readymade garments exports recorded 20.2% y-o-y growth in March 2017.

A closer look at the import composition also reports an increase across key import segments. What is particularly notable is the sharp increase in gold imports in January (147.6% increase y-o-y) and February (328.9% increase y-o-y) this year (data for March is awaited).

The increase in gold imports can be attributed to the domestic stock piling given the festivities surrounding Akshaya Tritiya and wedding season.

Also data with regard to India's export destinations which is available till February 2017 reported a pickup in exports to all major destinations including America, Europe, Asia and Oceania.

Recovery in the global economy is supporting export activity. The projections for global trade also indicate an improvement in 2017 and 2018.

Table 4: Total Exports by Regions (% Y-o-Y)

Month	Feb-16	Jan-17	Feb-17	2015-16	2016-17
World	-5.2	4.5	17.5	-15.5	4.7
Africa	-6.8	5.8	-0.6	-25.2	-9.5
America	-2.6	1.2	5.0	-11.2	3.0
Europe	-5	-3.8	14.1	-11.2	5.0
Asia	-5.7	10.7	27.6	-18.5	4.9
Oceania	-10.7	-18.7	11.9	16.0	-12.5

Source: CMIE

Despite the recent trends in exports, it remains important that India continues to strengthen its competitiveness in order to create a niche for itself and diversify its export basket. The Government launched the Trade Infrastructure for Export Scheme in March this year to bridge the infrastructure gap and provide forward and backward linkages to exporters. The Rs 600 crore scheme (Rs 200 crore/annum for three years) aims to develop export linked infrastructure in states to promote outbound shipments.

It would focus on projects like customs checkpoints, last mile connectivity, border haats and integrated check posts.

Also, amidst the current global environment of increasing protectionism in the West, India should look at playing a pivotal role in facilitating multilateral talks and signing preferential trade agreements with other emerging market economies.

The Fiscal Responsibility and Budget Management Committee Report prepared under the Chairmanship of Mr N K Singh was put in public domain in April 2017

Key Highlights

- Repeal the FRBM Act 2003 and FRBM Rules 2004
- Enact a new Debt and Fiscal Responsibility Act and in pursuance of the new Act, enact and adopt the Debt and Fiscal Responsibility Rules
- Achieve fiscal deficit to GDP ratio of 2.5% by 2023
- Adopt medium-term ceiling for general government debt of 60% of GDP, to be achieved by FY23. Within this ceiling, adopt a ceiling of 40% for Centre and 20% for States
- Suggestion to have an Escape Clause - trigger in case of emergencies. The deviation can be to the extent of 0.5% from the set fiscal deficit to GDP ratio

A Universal Basic Income Scheme for India?

There are three key aspects of a Universal Basic Income (UBI) scheme. First, it is universal, that is, it is not targeted to any specific group based on any socio-economic criteria. Second, it is an income or cash transfer scheme, not any specific good or service being provided in-kind or in a subsidized manner. Third, it is not contingent on compliance with any behavioural standards. This differentiates it from cash transfer schemes that are conditional on specific behavioural criteria for the recipients. For example, Latin American countries like Mexico and Brazil have programmes where families get a certain income transfer conditional on children attending school and family members receiving preventive health care.

The main strength of the UBI is it is simple and robust to various problems that afflict most anti-poverty programmes.

First, any programme that is not universal (e.g., food subsidies or employment guarantee) is associated with the direct or indirect administrative costs of targeting the relevant group. It also creates scope for inefficiency, errors of inclusion and exclusion (those who are not eligible getting it, and those who are eligible not getting it, respectively), and corruption.
Second, being a lump sum transfer of cash, it does not directly interfere with the operation of market forces in ensuring efficient resource allocation. This is a problem that is severe in the case of subsidies or free provision of certain goods and services that are also available on the market (e.g., food, fuel, fertilizer). They create excessive use by some, rationing for others, and in general stimulates the black-market by having multiple prices for the same good or service.

Third, not being contingent on any behavioural norms of recipients, it avoids setting up an entire administrative machinery aimed at monitoring compliance. This not only avoids the direct and indirect costs of running such a bureaucracy, it also removes the patron-client relationship that is inherent in any system of monitoring and rewards between the state and its citizens that is undesirable in a democracy.

Not just that, it allows individuals freedom of choice as to how to spend the money based on their specific needs and priorities.

Being a lump-sum transfer, it also does not directly interfere with the decision of individuals regarding productive activities, whether it is in terms of location or occupational choice or employment status. It could be argued it reduces the incentives to work by surviving without working possible. But working, like saving or investing or renting out property is one of many economic decisions that individuals take. A flat transfer can only affect it through what economists call an income effect – if you feel more affluent you may want to work less, which will also happen if wages or salaries go up. Given that the amounts being talked about in the Indian context are rather small (for example, Rs1200 per person per month would be the average amount according to my calculations) it is unlikely that having a minimum income will significantly interfere with the incentives of individuals to undertake productive activities.

It may appear that since both the rich and the poor will receive the same amount of income under a UBI scheme, it is not progressive or fair. However, this is a misconception as the rich pay taxes and will be net contributors while only the very poor will be net recipients of income under a UBI scheme. It is similar to our income tax scheme where a certain minimum level of income is not subject to tax for everybody, except for here the absolute minimum income is not zero, but a lump-sum transfer from the government.

Most of the opposition to UBI comes from the worry that the government would simply wash its hands off from any other forms of expenditure that the poor would benefit from, such as on health and education. Clearly expenditures on health and education are investments in human capital, and affect the growth potential of the economy, similar to investments in infrastructure. These should be delinked from any anti-poverty programmes, whether UBI or some other form of conditional or in-kind transfer, which provide short-run relief to the poor as opposed to a long-term solution.

However, even restricting attention to anti-poverty schemes, one could worry whether replacing some existing programmes that are working relatively well with an UBI may be risky. Even here, capping total benefits to some maximum amount would give beneficiaries the choice of holding on to benefits from programmes that work well, and giving up those that don't. Consider a relatively remote rural area where cash is less useful than in urban areas as markets are not well developed. It is possible that the poor in some of these areas may prefer to continue with some existing in-kind transfer programme to the extent they work well (e.g., food from ration shops).

Of course, the main issue concerning adopting a UBI scheme is affordability. Any universal programme is expensive. My calculations suggest that if every adult was given exactly the amount of income that defines the poverty level, which is on average Rs 40 per day (Rs 32 in rural areas and Rs 47 in urban areas), every person would be assured of an income of around Rs 14,000 per year or Rs 1,200 per month. Assuming we give this sum to every adult (0.69 of the population), this would require a total expenditure of Rs 11,600 billion, which is 11 per cent of the GDP. One can, of course, offer a lower amount per person that would be more affordable but there is clearly a trade-off between such a scheme being effective and affordable.

For such a programme not to add to the fiscal burden and create inflationary pressure, it must be funded either by spending cuts or by increased taxes.

Given that only 1 per cent of Indians pay income tax, while a mere 2.3 per cent file tax returns, the fiscal instruments to claw back the transfer from the rich are limited. However, the increased push for digitisation by the present government will reduce the space for informal transactions raise the possibility using instruments other than income tax (e.g., tax on bank transactions), it also make it feasible to make electronic transfers to the poor.

The scope for spending cuts certainly exists. The budgetary subsidies in 1987-88 amounted to 12.9% of GDP (based on the 2004-05 GDP series. In 2011-12 it amounted to 10.6% of GDP (also based on the 2004-05 series). Some recent estimates suggest that non-merit subsidies are about a third of this, making up about 3.5% of GDP. This is a far cry from the 11% figure.

However, it is a conservative estimate as administrative services are not included in it, nor are other subsidy like components such as direct transfers, concessional interest rates, concessional prices of land or other assets and tax concessions or exemptions.

So long as the UBI is not posed as the only instrument of poverty alleviation, there is no reason not to try it out at least on a scale that is affordable. No policy is without costs and those who only highlight problems with the UBI should recognize that whatever is their own favourite policy also has some advantages and disadvantages.

The focus should be on the relative costs and benefits of different policies and which one works better where and for whom. As we already noted, one size does not fit all, and we should be open to the possibility that different policies could work well in different settings. So long as we cap the overall benefits, there is no reason not to adopt such a flexible approach.

Finally, we should be clear-eyed about recognizing that UBI is only a temporary relief measure for the poor, and does not provide a long-term solution to the problem of poverty. For that one needs investment in health, education, and skill formation to enable the poor to take advantage of growth opportunities, and investing in infrastructure and regulatory conditions to facilitate private investment for employment generation. Growth is the best long-term anti-poverty programme.

The article is written by Prof. Maitreesh Ghatak, Professor of Economics, London School of Economics for FICCI's Economy Watch.

UBI dilemmas

Back in 2011, I happened to be involved in what to my mind are the only pilots on Universal Basic Income (UBI) in India. Never did I think, then, that UBI would become such a buzzword in policy circles.

The concept of a universal basic income is simple. It is an unconditional, regular payment made to every citizen as a form of social security. While the idea is old, it has been gaining currency of late around the world, given an environment of high inequality, increased automation and rising unemployment. In developing countries like India, it is increasingly being seen as a tool for fighting poverty. The Prime Minister has mentioned the concept in his recent speeches. The government's Economic Survey, 2016-17, has detailed extracts on how a regular, unconditional and uniform cash transfer to every adult and child can promote social justice and empower the poor to make their own economic choices.

The idea, however, has invited its share of scepticism. Wouldn't an unconditional payment be akin to charity? Would it encourage sloth, vices like addiction to alcohol? Should all Indians, including the rich, be guaranteed a basic income? Should UBI be a substitute to or complement existing welfare schemes such as the Public Distribution System (PDS) or the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA)? And most importantly, even if the government announces it, will it be able to afford it and implement it?

Some of these dilemmas were answered by our pilots. Funded by UNICEF and coordinated by the Self-Employed Women's Association (SEWA), the two pilots in MP involved paying every adult and child, a monthly payment of Rs. 300 and Rs. 150 respectively, for a year in eight non-tribal villages and a tribal village in MP. Other villages were visited for comparison.

First, we undertook the experiment because we believed that people are generally capable of making decisions which are in their own best interests. In other words, the state need not act as the all-knowing benefactor.

Here, the people in our pilot villages did not disappoint us. We found no evidence of an increase in spending on alcohol. In fact, we found people spending on their children's food, their education, on their household requirements, on household repairs. We also did not witness a rise in 'sloth'. On the contrary, we saw an increase in income earning and production, now that some extra funds allowed families to buy seeds and fertilizers. People worked more hours and branched out into secondary activities. The 'dole' or 'charity' was seen by them as a rare chance to invest money wisely, so it would pay them later.

The second dilemma is a financial one. The Economic Survey suggests that a basic income of Rs. 7,620 per person, every year would bring everyone but India's very poorest above the poverty line of Rs. 893 per month. Even if this amount is paid to only three in every four Indians – some measure of exclusion of the non-poor being applied (e.g. those owning land, consumer goods like refrigerators being excluded) – the total cost to the government would be about 4.9% of GDP, far higher than the present welfare schemes of subsidies on food, fertilizer and fuel which cost about 2.07% of GDP. This means that the government would have to consider removal of additional subsidies which also benefit the non-poor, including the middle class, for example subsidized train travel and loans – a politically challenging decision considering the resistance to demonetization.

In our pilot, the UBI served as a complement to existing welfare schemes. In fact, in most of our pilot villages, families that received the basic income used the money to buy food grains and stock them, given the uncertainty around their supply at the PDS. In other words, the PDS was still an important source of food security for villagers. They valued it, but couldn't rely on it given the irregular nature and quality of its supply.

One option to get around this challenge is to offer people a policy of choice. This as the Economic Survey rightly suggests would give people a sense of agency. In our pilots, we found families buying eggs, pulses, fruits and vegetables over and above the rice and sugar that the local PDS dealer supplied to them.

There was a marked shift in the nutritional status of children as a result of these choices. However, a policy of choice would also mean a reaffirmation of the current system with its incumbent problems of poor targeting, leakages and misallocation. As the Economic Survey points out: "those well-off who are currently (wrongly) included will continue to have the right to be included".

This problem can be countered, to an extent, by encouraging people to surrender the subsidy, just as the government did in the case of cooking gas. But at some stage, the state would have to consider a phased removal of food subsidy, if it has to realistically provide an inflation indexed UBI.

Yet another possibility – and might I add a more politically realistic one – is that the government rolls out a semi-targeted scheme i.e. give basic income to only those who deserve it. This can be achieved by applying principles of strict exclusion (e.g. excluding those owning land, consumer goods and so on) and principles of strict inclusion (including households without shelter, those living on alms, manual scavengers, primitive tribal groups etc.). The 2011 Socio Economic Caste Census offers detailed data on which families should be dropped and which ones included if such parameters are to be considered. That leaves the question on whether these parameters should be considered sacrosanct.

After all, households keep falling into and moving out of poverty. Those who own land may have to sell it in the event of a major illness in the family. If UBI is to provide a sense of social security as the government intends it to, it must focus on improving the country's health infrastructure, the 'poor health' of which is a major reason for people falling into poverty. The health expenditures in the GDP are therefore not to be reduced; instead the focus needs to be on providing more bang for the buck.

The third possibility is reducing the amount of the basic income offered. We achieved the results we did in our pilot even though we offered a miniscule amount (only Rs. 300 per person per month).

Let me conclude by relating a conversation I had recently with a bureaucrat. Though interested in the concept of basic income per se, he wondered if it would not be an admission of guilt by the polity on how they had failed India's poor through their welfare schemes. Perhaps we have, I responded. There is no running away from the evidence on the leakages and poor targeting that plague India's major centrally sponsored schemes. Perhaps it is time to give India's poor a stake in their own development. Perhaps basic income is an idea whose time has come.

The article is written by Ms. Soumya Kapoor Mehta, Development Economist and Co-Author of Basic Income: A Transformative Policy for India for FICCI's Economy Watch.

Designing the bad bank of India

To solve the problem of bad loans in India, the Reserve Bank of India (RBI) has introduced multiple schemes over the last few years: Flexible Refinancing of Infrastructure (5/25 scheme), Asset Reconstruction (ARC), Strategic Debt Restructuring (SDR), Asset Quality Review (AQR) and Sustainable Structuring of Stressed Assets (S4A).

However, the "twin balance sheet problem" persists. On the banking side, stressed assets now stand at over 12% of the total loans in the banking system. Public sector banks, which own almost 70% of banking assets, have a stressed-loan ratio of almost 16%. Banks are unwilling to take on fresh risks, which has led to negative growth of real credit, the lowest in over two decades. So, what now?

A new solution gaining popularity is the "bad bank". The concept is simple: Divide a bank's assets into two categories, good and bad. By separating the two, a bank can avoid the contamination of good assets by the bad. It also alleviates the concerns of investors and helps the bank focus on future lending by improving health and transparency.

However, while the concept of a bad bank is simple, the implementation can be quite complicated. A variety of organizational and financial choices are available while designing a bad bank. When RBI deputy governor Viral Acharya was asked if setting up a bad bank could be an effective solution to India's problem of bad loans, he said that it could help "if designed properly". So, how to design the bad bank of India?

A report by McKinsey & Co., "Understanding The Bad Bank", proposes four organizational models for a bad bank based on two decision factors.

First is to decide whether or not to keep the bad assets on the bank's balance sheet. Moving assets off the balance sheet is better for investors and counterparties and provides more transparency into the bank's core operations. But it is more complex and expensive.

Second, is to decide whether the bad-bank assets will be housed and managed in a banking entity or a special purpose vehicle (SPV).

Depending on the choices, the four basic bad-bank models are: on-balance-sheet guarantee, internal restructuring unit, special-purpose entity and bad-bank spin-off.

On-balance-sheet guarantee

In the on-balance-sheet guarantee structure, the bank gets a loss-guarantee from the government for a part of its portfolio. The model is simple, less expensive and can be implemented quickly. However, the transfer of risk is limited and bad assets continue to remain on the bank's balance sheet, clouding its core performance. This approach is useful for stabilizing a bank in trouble.

Consider the case of the Indian Overseas Bank (IOB). As of the quarter ended December 2016, the bank reported gross non-performing assets (NPAs) of 22.42%, net NPAs of 14.32% and a net loss of Rs554 crore. Since May 2016, the stock price of IOB has dropped more than 20%. An on-balance-sheet guarantee by the government can quickly restore confidence in the bank.

Internal restructuring unit

An internal restructuring unit is like setting up an internal bad bank. The bank places bad assets in a separate internal unit, assigns a separate management team and gives them clear incentives. This works well as a signalling mechanism to the market and increases the bank's transparency, if the results are reported separately.

It is clear that this model relies on the existing management team to restructure assets. However, if the existing management is looking to kick the can down the road, as is the case for many banks in India, this is not an effective solution.

Special-purpose entity

In a special-purpose entity structure, bad assets are offloaded into a SPV, securitized and sold to a diverse set of investors. The model works best for a small, homogeneous set of assets. The bad loan problem in India is concentrated in a few sectors like infrastructure and basic metals. An effective solution would be to transfer bad loans from these distressed sectors into sector-specific SPVs, securitize them and sell them in an auction. If the pricing is determined by the market, PSU bankers will receive less blame for losses to the exchequer.

Bad-bank spin-off

A bad-bank spin-off is the most familiar, thorough and effective bad-bank model. In a spin-off, the bank shifts bad assets into a separate banking entity, which ensures maximum risk transfer. But the model is complex and expensive because it requires setting up a separate organization, equipped with a skilled management team, IT systems and a regulatory compliance set-up. Also, the problem related to asset valuation and pricing will be the most severe in this model. The Public Sector Asset Rehabilitation Agency (PARA) proposed by the Economic Survey 2016-17 falls in this category.

However, given the complexity and cost of the model, it is recommended to be used as a last resort, after all other initiatives fail. Setting up a bad bank is a very complex process. It is not a silver bullet which will solve all the problems in the Indian banking sector. More importantly, a one-size-fits-all approach to designing a bad bank can be very expensive and less effective.

Just setting up one PARA will not be enough to get the banking sector back on track. The most efficient approach would be to design solutions tailor-made for different parts of India's bad loan problem.

The article is written by Prof. Rohan Chinchwadkar, Assistant Professor of Finance, Indian Institute of Management, Trichy. It was published in Mint on Feb 21, 2017.

Being too pushy about good governance?

Governance implies establishment of appropriate policies and monitoring of implementation, by those chosen to govern. Corporate governance is the framework under which a board of directors can collectively ensure fairness, accountability and transparency in a company's operations, relations with stakeholders, and the resolution of (and balance between) conflicting interests among stakeholders.

Problems caused by indifferent business governance globally, and at home in recent times, hurt the crucial but fragile three-way trust between government, business and society. Business usually finds itself at the receiving end of intrusive steps, ostensibly to avoid recurrence of unsavoury outcomes.

It's certain that transgressions by a few undeserving souls create difficulties for a much broader constituency. Blame games and cat-and-mouse tactics become systemic responses. The business community essentially abhors these infractions; but it cannot impose on others because they neither are privy to all facts nor have due standing in the affairs of such others.

Attitudinal issues

It is stating the obvious that enterprises must strive to cultivate an appropriate balance between business interests and their conduct. Governance must be seen as a cornerstone of long-term success and not just fulfilment of the letter of law. The attributes of good governance are entrenched in most of us. Our culture encourages owners of capital to act in trust for family and society while trying to do the best for the nation. The trust of society helped private enterprise growth through decades, even when the State largely viewed it with mistrust. This trust cannot be commonly assumed now.

A citizen's mind gets conditioned when the State works hard to improve interactions of citizens with itself — as the present government does — and he sees results.

In this backdrop it is difficult for him to comprehend that pressures, regulations and realities of conducting business have not adapted at the same speed; this triggers quick criticism of business by citizens and distorts overall perceptions and the socio-political environment.

Today, there is a lot of discussion on improving the ease of doing business, economic reforms, growth, competitiveness and global competition. Still, it could be argued that we are not yet at a stage where written words in policies reflect what leadership promises in the name of reform, simplified rules and true ease in conduct of running businesses.

The State carries the legacy burden of thinking rooted in the command-control-blame-penalise philosophy. Such attitudes do not suit contemporary needs. Unfortunately, the default instinct seems to be one of quickly undervaluing trust, and it may be easier to fix blame than fixing the problem. A purely comic analogy for the inertia is Asrani's “ itni badliyon ke baad bhi, hum nahin badle ” from Sholay ! This is the broader environment in which promoters and independent directors must govern.

Governance concerns

Areas under corporate governance are extensive, but let's restrict to key areas of concern and debate: (i) the collective welfare of all shareholders over narrow ownership interests; (ii) balancing key stakeholder interests, including fairness in dealings with lenders and creditors; (iii) compensations and succession planning; (iv) ethical standards; and (v) the evolving role of independent directors. It is incumbent on broader business, and not just (say) top 500 companies, to build simple but sound processes around these issues. It's a painful reminder that each of these areas has attaching strict regulations, contracts and processes, which any entrepreneur or professional director cannot overlook. Yet, a sensible reflection shows almost every major transgression or misapplication (of mind or intent) that has led to societal, governmental, institutional or societal pushback in recent years is traceable to these issues.

Despite many useful and positively-oriented laws, the Companies Act and SEBI rules react to failures by over-prescribing or micro managing. Thus begins a chain of arguments and counter-arguments between the regulator and regulated. Every infraction has a reason — it's an outcome either of circumstances or of intention. The former deserves forbearance; the latter, swift punitive disposal. Breast-beating or posturing achieves no outcome. Swift conclusions build systemic trust but require judicial infrastructure and processes, not more laws and rules.

It is a no-brainer that enterprise must avoid gifting any opportunity to the ecosystem to resort to knee-jerk responses or leverage fine print, more so when the issues demand pragmatic solutions. Equally, the government needs to understand it is very easy to offset trust which its positive statements generate, no matter how progressive new-fangled rules seem on the surface. I, for one, have yet to witness any global jurisdiction where tax or corporate laws have been able to prevent leakages or transgressions perpetrated by people determined to do so. The solution progressive jurisdictions provide is that the laws makes it certain — for an abider to abide, and for quick punishment for the guilty.

It comes from within

I confess being disturbed over an editorial in a business daily saying; "the threat of arbitrariness and excess hangs over Indian business today". This comes at a time when India requires businesses to invest, scale up and hire!

It is necessary for private enterprise to be cultivated (not cajoled!). The biggest injustice inflicted on the nation is when people remain in jobless poverty or in under-employment. Our livelihood creation, even at the "highest growth rates in the world", has not yet lent comfort.

The business community must hammer away at achieving certainty in laws and elimination of discretion. It must also introspect and accept that the weight of governance lies on each company's shoulders. It is not just "someone else's problem".

The fictional Judge Leonard White (Morgan Freeman in The Bonfire of the Vanities) captured the essence of governance: "The law is man's feeble attempt to lay down the principles of decency... decency isn't a deal, or a contract or an angle! It's in your bones."

The article is written by Mr. Sidharth Birla, Past President, FICCI. It was published in The Hindu Business Line on April 11, 2017.

Let's trust our entrepreneurs more

The summer promises to be hot. Fresh heat will arise from pressures in the global economy and manmade walls that threaten job losses for Indians literally all around the world. Enough has been written about growth and prospects, the disappointment of livelihoods and jobs not materialising, the absence of investments. So I will not dwell on these but on softer factors to serve as food for thought towards nurturing a favourable business environment.

Act of faith

Government investment, collection of taxes, and social support spending are in essence reallocation of resources. But the foundation for generating resources, without which its reallocation is meaningless, is business investment, value-added services, and agriculture. Investment is an act of faith. One must go beyond numbers that prima facie analyse consumer and investor sentiments, because faith and/or trust have roots in perception.

The Harvard Business Review recently carried an article on the global decline of people's trust in business, media and government. It suggested that mass outrage was not yet directed squarely against business or the elite, but there were signs that this could change.

The Edelman Trust Barometer 2017 notes that trust has moved beyond being a general feature, to a point when it is central to the functioning of a society. It suggests that a collapse of trust may by now be past a simple class versus mass problem, and could become a systemic threat.

People more often speak of a dilution of trust between government, civil society and enterprise. General mistrust of enterprise hurts all businesses and, indeed, all participants in the economy.

One must reflect that entrepreneurs will simply avoid investing if they feel that business difficulty has potential to malign them, or even threaten personal ruin. It is impossible for an entrepreneur to succeed if enterprise is mistrusted.

Some misgivings

This premise assumes greater meaning in a world that sees many governments turn increasingly protectionist, populist and interventionist in the unflinching belief that the best reaction to crisis or aberration is more regulation and/or punitive punishment.

While many noisy debates have been directed to enterprise in recent times two significant points have been: (i) attributing company behaviour to individual influences; and (ii) debt servicing by business. Surely, addressing misgivings due to inadequate facts or incorrect impressions merit due effort by the business community.

Corporate structures exist for genuine and time-tested reasons. The separate legal personality is a basic tenet on which company law is premised. In this context the epic case Salomon v Salomon formed the core of commercial law across the globe. In essence, the legal concept that separates the personality of a company from the personalities of its shareholders protects the latter from being held unduly or personally liable for the company's debts and other obligations.

The exception to this rule is lifting of the corporate veil under due process of law, where a court must determine if business was not conducted in accordance with corporate legislation or if a corporate form is either being abused or is a façade for improper, illegal or fraudulent actions. The choice to lift the veil cannot be arbitrary.

Law promotes structures where owner liability is per se limited, such as private companies, public companies (listed/unlisted) and LLPs. Company law casts strict obligations of governance and accountability in all cases, with tougher standards for listed companies where sensitivity to multi-stakeholder segments and broad-based decision-making becomes obligatory. Summarising this aspect, reality dictates that organisational decisions follow due process.

If the contrary is seen to occur, resolution must not be overbearing (and sometimes be forgiving) when there is no substantive cause, and be unsparing when there is. Enforcement will build trust. Capital employed in a business typically exceeds the risk capital from shareholders. All financial exposures to a business must therefore accept a risk-reward weightage. Stressed loans do not all arise from poor decisions or losses; it is conceivable, for example, that a profitable entity may be generating inadequate cash flows.

Risks to integrity

But under a shrill debate by regulators, government and media on bank woes it becomes almost impossible to represent the fact that problem loans are most usually the outcome of investment enthusiasm confronting reality, while mala fide is the exception. It's also tough to calm the passions of and describe to society why a business loan is different from a personal loan to, say, purchase a car. Or that loans are funded significantly by liabilities to bank depositors rather than largely by taxpayers. The reality is that risks to system integrity outweigh risks to taxpayer money. It needs to be argued that under present governance norms and new insolvency laws, collateral devices such as personal guarantees create a deceptive sense of comfort (often delaying timely action). When entrepreneurs do assume (usually under duress) obligations of debt guarantee, its realisation deserves to be via contract enforcement and not through over-arching impositions.

In addition, for enterprise to assign and/or abide by a moral accountability towards liabilities is more in harmony with our values and increases social trust.

When entrepreneurs do assume (usually under duress) obligations of debt guarantee, its realisation deserves to be via contract enforcement and not through over-arching impositions. In addition, for enterprise to assign and/or abide by a moral accountability towards liabilities is more in harmony with our values and increases social trust.

An onerous task for all leaders is to rekindle trust in (business) institutions. Enterprise must also be sensitive that legacy pain, including that of an overbearing state or confiscatory taxation, can no longer be an alibi for present or future deviations. It's a different world now.

Trust in enterprise must not fall, else populism/activism will almost surely create havoc through divisive rhetoric and/or unpleasant policies. Objective introspection and course correction by all constituencies can lead to explicit assertion of trust and moderated approaches all around.

I paraphrase what my great-grandfather Sri BM Birla said at a Ficci assembly in April 1977: "I find a tendency among businessmen to...feel aggrieved that their role is not fully recognised and appreciated by authorities and public... If we are criticized...either our conduct has not been good, or we have not made efforts to set right uninformed criticism." He could have been speaking now!

The article is written by Mr. Sidharth Birla, Past President, FICCI. It was published in The Hindu Business Line on April 27, 2017.

Green Growth Opportunities for Asia

While countries across the globe are pursuing various economic growth models, there has been a growing consensus over the fact that the goal of higher economic output should not be achieved at the expense of environment. Asian economies are amongst the first to have understood and realised this critical aspect. Countries such as China, India, Philippines have placed greater emphasis on achieving sustainable development by promoting 'green growth' i.e. growth that is attained without depleting the present stock of natural resources or causing any adverse impact on the environment.

One of the papers published by Asian Development Bank (ADB), titled – 'Green Growth: Opportunities for Asia', has estimated the size of the green economy in Asia and has projected the future growth prospects of Asia's green economy. The paper has also presented a set of policies which could help the Asian economies foster green growth.

Size of green industry in Asia

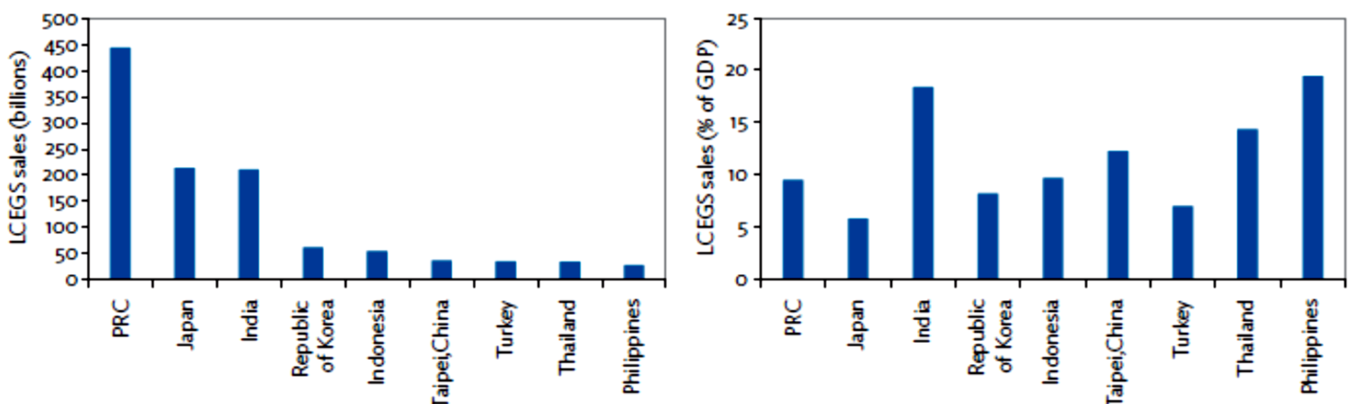
For evaluation, ADB paper has primarily focused on Low-Carbon Environmental Goods and Services (LCEGS) data set comprising sales data (greater green industry can be captured) green operations and technologies, rather than just final goods for estimating the size of the green economy. It has also used trade and patent data on climate change mitigation technologies (CCMT).

ADB analysis reveals that, Asia has the largest value of green sales (both in absolute terms and as per unit of GDP) relative to other countries. However, its regional disparities are stark. Within Asia, the People Republic of China (PRC) has the largest value of green sales and is second globally only to the US.

However, relative to GDP, Philippines has the highest value of LCEGS sales, followed by India. In both of these countries, LCEGS sales are worth approximately a fifth of their GDP, while in the PRC they are a tenth. Globally, the top five countries in terms of absolute value of LCEGS sales are the US, the PRC, Japan, India, Germany, and the United Kingdom, in that order.

ADB in its report states that Asia accounts for 44% of global CCMT exports, with China alone accounting for 20% of global CCMT exports. In terms of innovation, the report states that Asia in 2012 had filed more high-value CCMT patents than either Europe or Latin America, and Japan and Republic of Korea are its leading innovators.

Chart 1: Largest Absolute Value of Low-Carbon Environmental Goods and Services



GDP = gross domestic product, LCEGS = Low-Carbon Environmental Goods and Services, PRC = People's Republic of China.
Note: Data are from 2011 to 2012.
Sources: United Kingdom Department for Business, Innovation and Skills 2011; Vivid Economics.

Chart 2: Share of Global CCMT exports

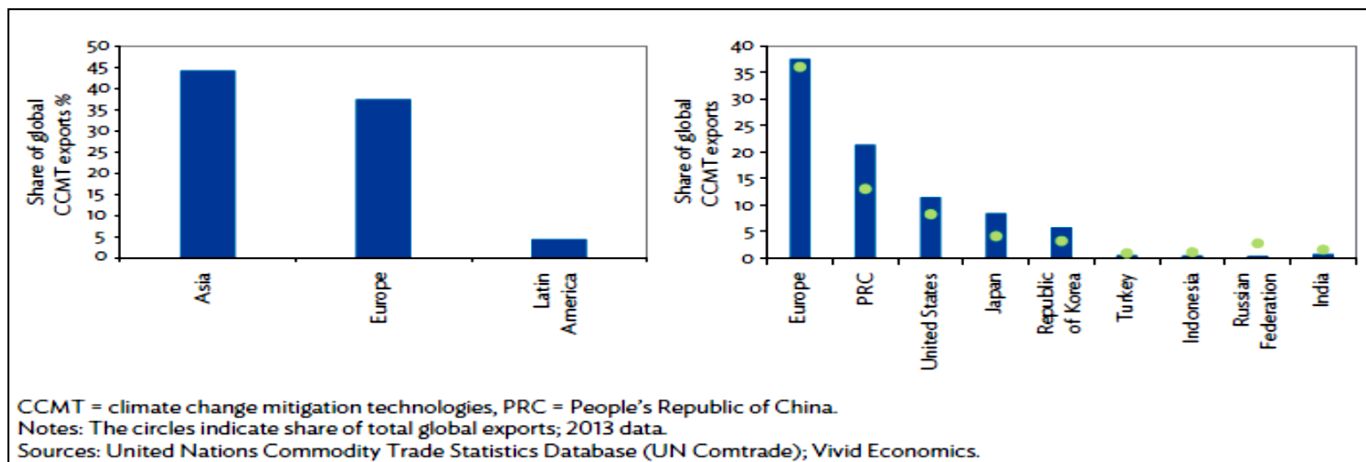
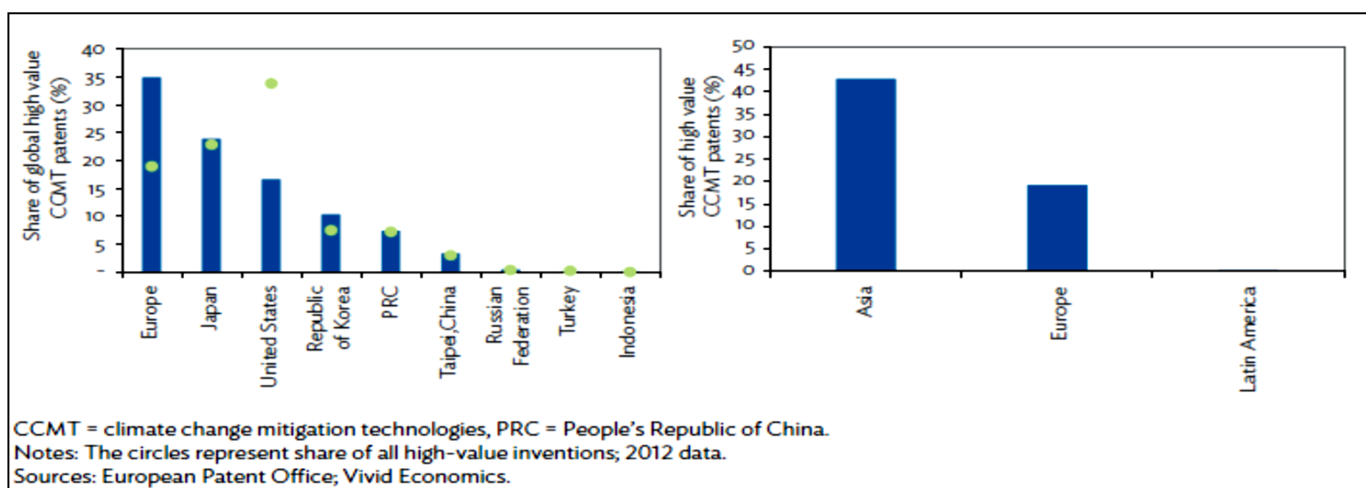


Chart 3: Number of High Value CCMT Patents in 2012



Future Green Growth Economy

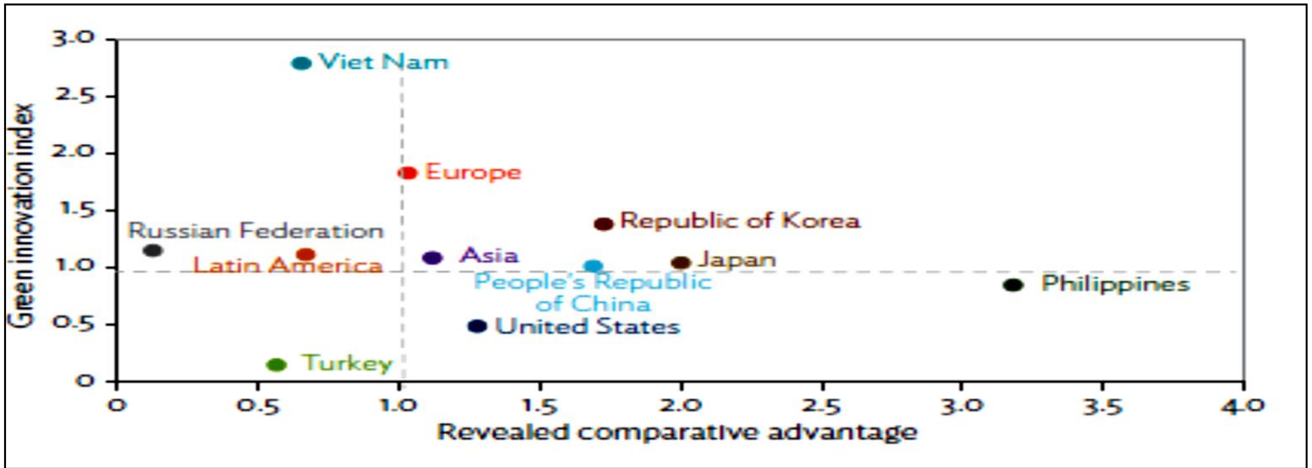
ADB report attempts to understand how well placed Asia is to capture value from the future green economy by looking at the level of innovation and degree of trade specialization in key low-carbon technologies. The methodology used for estimating future size of green economy employs two indicators, Green Innovation Index (GII) and Balassa Index of Revealed Comparative Advantage (RCA).

GII uses patent data to indicate whether a country specializes in innovating a green technology. If a country has an "innovation specialization", then it has promising prospects of becoming a global innovation leader in that technology.

The Balassa index of RCA employs trade data to assess whether economies have a current specialization in low-carbon technologies.

The paper highlights that a substantial and thriving green economy already exists in Asia with Asian companies playing important roles. Global sales of green goods and services amounts to US$ 2.9 trillion a year the report states. Asia has an RCA and innovation specialization in CCMTs and Developing Asia accounts for 22% of the global high-value CCMT patents and 35% of exports. It adds that overall Asia's position as an exporter of CCMTs is stronger than its position as an innovator and PRC, Japan and the Republic of Korea are key exporters and innovators in CCMTs accounting for a large share of Asia's export and high-value patenting activity.

Chart 4: Innovation Specialization and Revealed Comparative Advantage in CCMTs

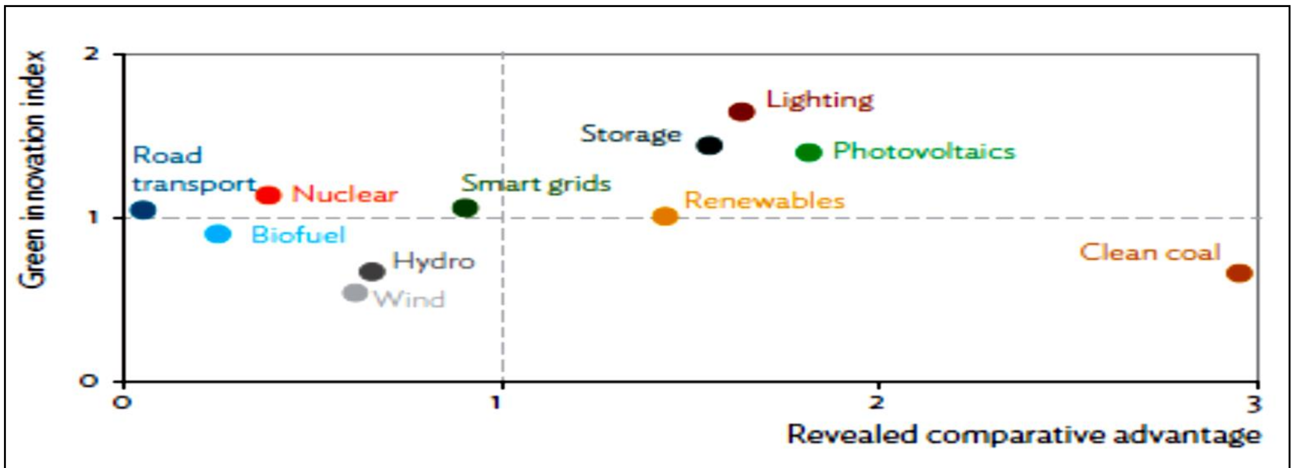


Notes: 2012 data for green innovation index (GII) and revealed comparative advantage (RCA). For the GII, regional CCMT patenting activity is normalized by the share of global patenting activity. Apart from Viet Nam and the Philippines, all regions have a share of global patenting activity that exceeds 0.4%. A low normalizing factor explains Viet Nam's high score on the GII. Similarly, for RCA, all regions have an export share that exceeds 1% of global exports apart from the Philippines, which explains its high RCA score. Results for such countries should be interpreted with caution.
Sources: International Energy Agency; United Nations Commodity Trade Statistics Database (UN Comtrade); European Patent Office; Vivid Economics.

It adds that India, Philippines and Vietnam are not frontier innovators in CCMTs, they often undertake incremental innovation. Asia's core strength lies in efficient lighting, photovoltaics and energy storage where it has both an innovation and export specialization and adds that developing Asian countries have strong comparative advantage in certain CCMTs such as photovoltaics, of which it is the world's largest exporter.

The paper has identified certain key opportunities for Asia which include nuclear power, efficient road transport and smart grids – technologies which are expected to have large markets by 2050 by International Energy Agency. Asia could leverage its position as an innovator to engage in greater exports of these technologies, and in some of these areas, the region is leading the market transformation.

Chart 5: Asia's Key Strengths and Opportunities



Note: 2012 data for green innovation index and revealed comparative advantage. Asia.
Sources: International Energy Agency; United Nations Commodity Trade Statistics Database (UN Comtrade); European Patent Office; Vivid Economics.

People's Republic of China

According to the ADB paper, economic growth has severely compromised the quality of the environment in PRC, however, the government has made substantial efforts to control pollution, which is particularly visible in renewables (world's largest wind power capacity) and is committed to peak emissions by 2020. PRC is an exporter (one fifth of global CCMT exports) more than an innovator of CCMTs. It is an early adopter of CCMTs and engages in high levels of manufacturing and export, it is not a frontier innovator in CCMTs and innovative capacity will not be an immediate driver of future success in the green economy. The country's main strength is in efficient lighting where it has both innovation and export specialization, while nuclear power where it has high levels of innovation provides opportunity. The paper recommends that PRC has to start engaging in technology rather than process innovation and ensure appropriate technology transfer policies are in place.

Philippines

The government of Philippines acknowledging the importance of tackling climate change has created the National Framework Strategy on Climate Change for 2010–2022 which places great emphasis on adaptation, with reference to mitigation as a function of adaptation. The country excels in a number of low-carbon metrics, has the highest level of LCEGS sales as a percentage of GDP in Asia, excels in CO2 productivity since it has the highest GDP per unit of energy-related CO2 emissions in Asia, and scores well on energy productivity, where it comes in second place after Vietnam. Philippines generates 52% of its energy from renewables, primarily geothermal and hydropower. ADB study finds that Philippines enjoys a comparative advantage in few CCMTs, efficient lighting, photovoltaics and energy storage and has room for improvement in innovation. While the country does not innovate (almost zero high-value patenting activity) in CCMTs, it appears to be engaging in other aspects of green growth such as protection of natural capital (maintaining forest cover). Overall, the analysis demonstrates that Philippines has potential to capture value from export in the green economy but not design. It will be relatively dependent on international trade and assistance to obtain the latest CCMTs.

Vietnam

Vietnam has almost no high-value patents in CCMTs. It however enjoys a comparative advantage in wind, energy storage, and biofuels, which reflects government efforts to encourage the development of wind and biofuels. Currently, the country is not well placed to capture value from the green economy. Its National Green Growth Strategy (2012) sets out objectives toward a green economy, energy efficiency, GHG reduction, and improvement of living standards and initiatives include green city planning, changes to fuel structure in industry and transport and increase in the proportion of new and renewable energy sources.

Indonesia

Indonesia is one of the largest GHG emitters in the world, in absolute terms, due to high levels of deforestation (80% of GHG emissions). In addition, 95% of Indonesia's energy supply is made up of fossil fuels. ADB analysis reveals that Indonesia enjoys neither any strong comparative advantages nor an innovation specialization in any CCMT, a relatively weak position in the green economy. It states Indonesia with low innovation (next to no patenting activity) and export (0.5% of global CCMT exports) is poorly placed to capture value from the green economy. However, it adds that Indonesia which has 40% of the world's geothermal energy resources has latent potential which needs to be harnessed through effective policy.

India

India too is one of the world's largest GHG emitters with a strong expected growth in emissions. Given the country's large dependence on rain-fed agriculture, India is also highly exposed to risks of climate change and it is becoming increasingly open to the idea of unilateral action against climate change. The paper has also described about India's National Action Plan on Climate Change released in 2008 with eight missions that target solar power development, energy efficiency, reforestation, and skills development. ADB paper has not attempted to calculate GII for India as the data was not sufficiently robust.

However, quoting OECD data, the report states that India has been increasing its share of green innovation and has developed a relative advantage in environment related technologies. ADB states that India is known to undertake incremental innovation that adapts technologies (reverse-engineer technologies to keep essentials and reduce costs) to the local context and develops new products that are suitable for the poor and are more environmental friendly. However, despite the progress, India still lags behind comparator nations such as PRC and its position on CCMT exports is weak and it does not have a big base of CCMT manufacturing to build on, the report adds.

The paper suggests that Indian policy makers have to take a critical decision on coal and decide how to phase out dependence on the same and though overall, there are signs of progress on both the innovation and export front, but the larger abatement story hinges on choices related to the role of coal in electricity generation.

Republic of Korea

The Republic of Korea was one of the first countries to announce a green growth plan, its National Strategy for Green Growth (2009-2050), following which research and development (R&D) expenditure related to green growth and the share of green overseas development assistance grew rapidly. The result of this is that the Republic of Korea has strengths in multiple technologies and the report states that the Republic of Korea's economy is becoming greener, with environmental and resource productivity, including CO2 emissions productivity, energy productivity and domestic material consumption.

ADB's analysis points that the Republic of Korea has a strong RCA and GII in several technologies and is well placed to take advantage of the future of green economy across nuclear, photovoltaics, lighting and storage and is poised to have one of the world's largest energy storage systems. It adds that though Republic of Korea and Japan have strong innovation for smart meters, they are yet to develop their export markets suggesting that they may be future competitors in this technology.

The data suggests that Republic of Korea may have a coordinated focus on innovating products where it has an existing export advantage thus playing to its strengths, and other Asian countries could learn lessons from the Republic of Korea's ongoing green economy transition

Japan

Japan has made substantial headway towards decoupling growth from emission, resulting in a drop in emissions from traditional air pollutants such as sulfur oxides and nitrogen oxides during 2002-2007 despite a growing economy and likewise Japan's energy intensity as measured by energy supply per unit of GDP has also been on a decline. Japan's overarching green economy objective for 2020 is to generate market value of over Yen 50 trillion and 1.4 million jobs in environment-related sectors. It also aims to reduce global GHG emissions by promoting Japanese technology worldwide. Japan files the highest number of high-value CCMT patents in Asia, with a focus on transport energy storage and buildings, the report adds.

The analysis of the paper states that Japan appears well poised to capture future value from green transport and also has the opportunity to develop its smart grid sector by focusing on capturing global market share through exports and building manufacturing capacity. However, it adds that Japan's nuclear technology is at risk of being overtaken by that of the PRC due to Japan's relatively low levels of innovation and the effects of the Fukushima incident on public opinion for nuclear. Japan must still ensure that aging industries are well prepared for competition from developing Asia.

Policies for Pursuing Green Growth

On the policy front, the report recommends that Asian countries may need to harness future opportunities. It states that it is not necessarily the case that all countries should attempt to maximize their levels of innovation and export in all technologies. What is important is that countries have a strategic approach on which technologies and sectors to pursue, and are not under-innovating in a technology in which they inherently have a competitive advantage and/or which carries immense spillover benefits for the economy.

The report states that some Asian economies have found it difficult to harness their potential in CCMTs, due to market failures that include limited access to finance, distorted prices, information asymmetries, and coordination failures. It adds that methods to correct market failure include innovation and industrial policy. The paper examines price and non-price mechanisms to correct these market failures.

Price mechanisms: The report states that the inaccurate pricing of GHG emissions is one of the main market imperfections that prohibits growth, which could be addressed by setting appropriate prices through taxation or subsidy schemes. Analysis finds that carbon taxation also helps spur green innovation, which carries significant spillover benefits in the form of facilitating a green economy transformation. Governments can explore mechanisms to support clean technologies such as subsidies for renewables or electric vehicles, ADB paper recommends.

Non-price mechanism: The report states that price mechanisms are not always sufficient for delivering innovation and investment without complementary, nonmarket measures. It suggests that non-price mechanisms need to focus on regulation, skills and financing. For regulation, it is important to have policies which support technology transfer and a combination of international negotiation and adjustment of national IP regimes should be considered to ensure appropriate levels of technology diffusion. Government support for R&D towards green innovation and regulation such as efficiency standards, planning rules, and building codes can also help spur green innovation, the report states.

In addition, the government should play its role as a market maker or provider of critical infrastructure. With respect to skills, the paper observes that a two-step strategy may be adopted wherein first step would be to define a green growth strategy and pick areas for development following which measures to ensure that appropriate skills and training programs are in place. Referring to India, the report states that India can leverage its base of skilled software professionals to further develop and consolidate its comparative advantage in smart grid technology.

The paper states that policies to remove financial barriers are essential for takeoff of growth and it could include innovation funds, payment-by-results schemes or green bonds.

The paper further states that strategies to ease the cost of transition, by supporting labor mobility and creating the industrial champions of the new green economy is an essential part of the overall policy mix and phased approaches and methods should be adopted.

Conclusion

The analysis shows that as a whole, Asia is on track to capture value from design and export of key CCMTs (energy storage, photovoltaics, and efficient lighting), however, there is room for growth by developing specializations in additional CCMTs, ensuring the green economy transformation is occurring equally across all Asian countries, and further advancing policies to enable this transformation. ADB states that within Asia, trade and integration can help diffuse CCMT technologies throughout the continent to the benefit of both top innovators and developing countries.

Financial Inclusion in the Digital Age

Introduction

Globally, financial systems are increasingly offering more services in several areas including savings, credit, investment, insurance and retirement. However, much needs to be done to provide quality services at low cost to people and businesses in urban, rural as well as poorer regions. Development of information and communication technology applied to financial services provides new opportunities to increase financial inclusion but it requires greater financial awareness and literacy. Consumers also need to be fully informed of the costs and risks of the financial products on offer. Also, traditional commercial and retail banks are finding digitized finance to be disruptive and they need to adapt and find ways to provide electronic services to meet the growing demands of their customers.

The policies needed to promote financial inclusion in the digital age were discussed at an international conference held at Asian Development Bank Institute in April (7-8) 2016. ADB's policy brief on 'Financial Inclusion in Digital Age' is a review of the key issues and policy suggestions made during the conference. The paper makes seven key policy suggestions which are discussed here.

- **Strengthen the credit information system to facilitate delivery of financial services to the new customers**

ADB paper highlights that timely and accurate credit information is critical for a well-functioning financial industry and about 32% of credit bureaus use only negative data and provide an incomplete assessment of a borrower's risk. It therefore suggests that governments should collect comprehensive data at the subject level, which when combined/paired with data from other sources would give a more accurate picture. The data should be made available to registries and bureaus to improve their abilities in providing public services, financial services, creating policy, conducting statistical analysis. Further, individuals owning data must have the unilateral authority to revoke access by others.

The paper cites examples of Philippines and Republic of Korea. In Philippines local banks are serving microborrowers through communication and cooperation with cooperatives, rural banks, and microfinance institutions; while in Republic of Korea, the Subprime Credit Bureau has been able to implement effective anti-fraud systems; offer customized credit scores for subprime lenders; and introduce application service provider solutions to start-ups and small subprime financial companies. Readily available data therefore may be used for smaller loans, given the lack of data for credit scoring provided there is proper monitoring to protect borrowers from unscrupulous lenders. More effort is also required to translate the subjective knowledge into traditional data forms through compliance and documentation and enable the borrower to access the wider financial system.

- **Develop new microinsurance services to reach the poor**

Microinsurance has a potential market of 3 million people with possibly US$ 30 billion in revenue from insurance premiums. However, currently only 5% of the total markets in Asia, Africa and Latin America is covered under microinsurance. Also, only about 20% of the total microinsurance is provided by microfinance companies globally. Microinsurance therefore must expand globally to meet the needs of the poor, the report states.

Elaborating on the experience of Philippines, the paper states that microinsurance has emerged as a vital financial service for the poor in the country due to widespread poverty and frequent natural disasters. However, in the aftermath of typhoon Haiyan in 2013, insurance services operations were disrupted and the spike in claims threatened financial sustainability leading to rethinking of business models. Hence the paper suggests that offering variety of financial products addressing specific needs could be more effective and provide better value than standard single product solutions. Moreover, new digital solutions may be more resilient to the physical problems/challenges faced during any disaster recovery, it adds.

The paper however highlights that though mobile phone is a useful tool for financial inclusion, the experience of BIMA (a specialized global insurance intermediary, operating as a licensed agent or broker with the aim of bridging the gap between insurance companies and the target group of bottom of the pyramid customers), shows that in some developing countries there is still a huge gap (often 70% or more) between the level of mobile phone penetration and usage. Nearly half of their customers do not have access to formal bank accounts or mobile money wallets; and moreover, 80% of these customers are also accessing the products for the first time. Financial services still require human interaction to build trust, assess the capability of new clients and bridge their lack of education.

Another area for improving microinsurance is proportional regulation of products according to size and scope to nurture growth. Providers are hesitant to offer new products in the face of uncertain regulation while taking on traditional demand-side risk; and overregulation may also stifle growth as it might hamper firms from adapting to market demand in a timely and appropriate manner especially given the unpredictable nature of disaster risks and the speedy evolution of digital finance. ADB paper thus suggests that there is an urgent need for harmonized regulation across different government agencies given the overlaps in jurisdiction pertaining to digital delivery of products.

- **Strengthen risk-based monitoring of cross-border transactions to protect remittance dependent households and communities**

Cross-border transactions or remittances were the fastest growing mobile money product in 2015 and they far exceed official development assistance and FDI as a source of funds for most developing economies. It adds that competition in the financial market in the form of players as well as from social media firms have exerted downward pressure on prices and have encouraged a greater shift towards digital payments, given its cost advantages. While reducing the cost of remittances helps the poor, people relying on remittances face other risks/concerns from the financial system including corruption and money laundering, the report states.

The paper recommends that local and global coordination between jurisdictions and engagement of regulatory bodies need to ensure that the de-risking measures that affect money transfers follow risk-based regulatory models and maintain key services for the migrant workers.

- **Reform financial regulations to promote savings through formal channels**

Household savings contribute to domestic investment and reduce the reliance on foreign funding sources. Formal financial service providers and mobile money operators are key to collecting the savings nationwide including in the rural areas and they are a key distribution channel.

It adds that the government and financial service providers should approach financial inclusion through the entire financial system wherein each agent will have a defined role, using financial education to clearly communicate the idea behind the various financial products. Clear rules governing these activities as well as an appropriate regulatory framework should result in an enabling environment to integrate households into the formal banking system, the report states.

In this context, the ADB paper has cited the case of India, where reliability of the system and reforms created an atmosphere to promote savings through formal channels. The reforms addressed the issues such as management of increasing costs, inter-channel competition, disruptive technologies, coordination and trust, product duplication and differentiation and the risk of oversaturation of savings programs.

Further, the Pradhan Mantri Jan Dhan Yojana (PMJDY) established banking outlets within reasonable distance to service areas and provided customers with debit cards as well as various insurance products. Another example cited from India was an initiative taken by Cashpor, ICICI Bank and EKO India financial services to provide digital credit and savings products. The program used the existing infrastructure to serve clients while investing in capacity building and training of staff in addition to repeated confidence building activities for clients. This led to doubling of individual savings accounts between 2010 and 2015.

- **Develop financial infrastructure to expand services to small businesses**

ADB in its paper states that Micro, small, and medium-sized enterprises (MSMEs) need supporting financial services such as secured transaction frameworks, credit information systems, and insolvency regimes, which can be provided by a combination of public and private entities.

The paper highlights that in APEC, MSMEs contribute to over 60% of total employment, 40% of gross domestic product, and 15% of total exports, however; approximately 40% of the financing needs of these MSMEs are underserved. This is because of several factors that stem from their size and include difficult time in accessing formal credit due to lack of hard assets and they struggle to finance their business or expansion as they lack cash and almost always facing higher transaction costs. It adds that MSMEs also have limited ability for risk management, cash flow management and resource management. As MSMEs do not have a credit score they do not qualify for the usual bank credit assessment process and their assessment is done by the branch manager involving high costs to secure working capital, low transparency of the assessment process and poor user experience for the MSMEs.

ADB paper advises that these shortcomings can be overcome with digital technology solutions. It further adds that special priority must be given to the development of financial infrastructure especially operating infrastructure to achieve economies of scale. Financial infrastructure operators should use latest modern technologies to keep pace with the evolution of digital finance. Private Credit risk database can be developed to improve credit information on potential MSME borrowers, ADB adds.

- **Improve financial education and financial literacy to expand financial inclusion**

As financial inclusion expands, it would reach people who have no prior experience with formal finance and some new customers of financial services may lack understanding of financial services and fail to use the services fully or properly. Hence financial education becomes a crucial component of successful financial inclusion. It adds that significant gap in financial literacy is noticed even in the advanced economies.

Citing the example of Japan, ADB shows the opportunities and constraints in combining new financial services with financial education. Japan resorted to utilizing the Japan Post and World War II widows to sell life insurance products and create financial awareness in small business and agricultural workers. Despite successful expansion of financial services in Japan, financial literacy in Japan remains limited as school teachers themselves lack financial literacy skills, the report states. Hence, it is common for small businesses in Japan to teach basic accounting and finance skills to their employees.

With reference to Malaysia, ADB states that the Credit Counselling and Debt Management Agency (APKP) found that most of the loan defaults (52%) are due to poor financial planning. Further the report states, priority issues vary with age group- younger people lacked awareness, middle aged people lacked cash flow and credit management while older people required greater understanding of retirement issues and retirement planning. Accordingly, the agency developed different modules to cater to the financial education needs arising at the various stages of a person's life. The agency also chose to prioritize vulnerable groups with the aim to reduce the frequency and level of their financial missteps. ADB states that financial education should be included in standard school curriculum at every level. However to do that, appropriate training should be given to the teachers first.

- **Evolve and adapt financial regulations to suit digital finance**

Digital Financial Services (DFS) is being used globally to expand financial inclusion. Consequently, it must be developed and regulated with proper measures to safeguard against risks and to provide/secure consumer protection. ADB citing examples explains how different approaches to such regulations can restrict or spur the growth of DFS. In Cambodia, DFS market is dominated by only one operator, Wing, which covers 80% of the market while there are some other players that also provide mobile banking, online banking and agent banking services.

Hence, entering the DFS market is extremely difficult in Cambodia since the new entrant has to find a partner bank that must follow a set of compliance procedure as designated by the authorities. It adds that on the contrary, in Philippines, more than 100 banks cover e-banking facilities and there are 30 e-money issuers. Regulations, announced in 2009 clearly specify the prohibited activities and allow the banks to outsource a wide range of activities without requiring approvals from regulators. This has enabled even rural banks to develop linkages with different partners. Cloud computing in Philippines has enabled mid-sized banks to gain access to the digital infrastructure and computational resource for protection, although public cloud is prohibited in core operations, it adds. ADB further adds that even with regulations that allow growth, the same environment can constrain development of DFS.

In Philippines despite such enabling regulations, only 1% of total 2.5 million transactions per month are done digitally due to limited interoperability of the domestic payment systems. It adds while major payment operators have their own payment system, smaller operators are unable to participate in the DFS market and their operations are restricted to cash and check. 36% of the municipalities in Philippines have no financial institutions, ADB states in the report. ADB recommends that financial regulators should consider policies to allow potential/new entrants to receive individual licenses without being attached to a bank. Regulators should also have separate safeguards for consumer protection. Moreover, the governments and the private sector should consider on how the finance sector infrastructure requirements needs to evolve and adapt to both regulate and develop new DFS.

Can Tax Incentives for Electronic Payments Reduce the Shadow Economy? Korea's attempt to Reduce Underreporting in Retail Businesses

Introduction

Cash transactions have always been a facilitator of shadow economy. Transactions made in cash do not leave an audit trail and may lead to underreporting of goods and services purchased or sold, thereby resulting in non-payment of taxes and loss of tax revenue. Hence, countries are making concerted efforts to implement measures to encourage businesses and consumers to use formal channels (banks and other electronic modes) of payment and discourage cash transactions to a great extent.

Special tax incentives have been extended in some countries to encourage reporting of business to consumer (B2C) transactions and use banking channels. For instance in Columbia, individuals are offered a 2% VAT refund on purchases made by debit/ credit card or electronic banking. Similarly in Argentina, debit cardholders are given a 5% reduction in basic VAT rate of 21% on all purchases under Arg$1,000 (US$220).

South Korea has attempted to increase tax revenues by widening tax base and reducing shadow economy through its tax policy since 1996. A Working Paper by the World Bank titled 'Can Tax Incentives for Electronic Payments Reduce the Shadow Economy? Korea's attempt to Reduce Underreporting in Retail Businesses' examines the impact of tax incentives for electronically traceable payments introduced by Korea in 1999 to promote payments made using credit cards, debit cards, and electronic cash receipts in business-to-consumer transactions. The paper focuses on the shadow economy comprising of productive legal activities concealed from the authority in order to evade paying income or other value-added taxes.

Global Experiences: Policy measures to reduce shadow economy

According to the paper, shadow economy defined from the perspective of taxation comprises two types of activities:

a. ***Undeclared work:*** Activities of unregistered informal enterprises or individuals

b. ***Underreporting of sales:*** Activities of registered companies in the formal sector intentionally underreporting their sales

The paper highlights some of the tax based policy measures taken globally to capture the informal transactions, targeting both buyers as well as sellers. Broadly, polices have been designed to either restrict sellers or buyers from undertaking informal transactions or encouraging them to declare or report all transactions. Some of these measures adopted in various countries are given below.

Measures Targeting Undeclared Work

In Europe, undeclared work accounts for roughly two-thirds of the shadow economy, while the remaining comes from underreporting. Therefore, nearly 100 out of total about 200 measures in use in European countries against the shadow economy focuses on undeclared work. So the countries have either adopted deterrent or incentive measures to convert the shadow industry into formal economy.

Deterrent policy measures

Italy: As per a law passed in 2006 in the country, a retailer who fails to issue a sales receipt three times in a five-year period can be asked to close operations, and construction sites can be shut down if employment irregularities are found. It is also illegal to use cash to pay more than €100 for professional services. Additionally, buyers of undeclared work are mandated to keep receipts to be presented to the authorities to avoid sanctions.

Norway: In Norway, purchasers of undeclared work have to pay using electronic modes of payment or keep invoices for a specified time to avoid criminal liabilities.

Many countries have also places restriction on cash payments by prescribing a maximum limit to it.

Country	Cash payment restrictions	Implementation date
Belgium	€3,000	January 1, 2014
Bulgaria	Lev 10,000 (€5,112)	July 1, 2011
Czech Republic	CZK 350,000 (€12,763)	January 1, 2013
Denmark	DKr 10,000 (€1,340)	July 1, 2012
France	€3,000 (resident and non-resident traders) €15,000 (non-resident consumers)	January 1, 2002
Greece	€1,500	January 1, 2011
Hungary	Ft 1.5 million (€5,000) (legal persons)	January 1, 2013
Italy	€999.99	December 6, 2012
Portugal	€1,000	May 14, 2012
Slovak Republic	€5,000 €15,000 (natural persons who are not entrepreneurs)	January 1, 2013
Spain	€2,500 (residents) €15,000 (non-residents)	November 19, 2012

However, the paper cautions that since cash transactions mostly take place with mutual consent of buyers and sellers, with both parties agreeing to pay and receive any amount of cash without leaving a trace, such transactions are difficult to trace and placing cash limits could have limited effect.

Incentive policy measures

Monetary or nonmonetary incentives have been introduced in several EU countries to address one of the most common undeclared work i.e. household services.

Belgium: Tax reductions have been linked to the use of vouchers used to hire household services.

Denmark: In 1994, Denmark became the first country to introduce a subsidy (as a percentage of cost) to support household services.

Finland: A tax deduction system was introduced in 1997 for household services within the taxpayer's own house or in an elderly relative's home.

France: France allows 50 percent of expenses for cleaning, ironing, IT assistance, or private lessons as deductions for income tax. Tax deductions are also given to households either directly employing an individual service supplier at home or hiring a service company.

Germany: Tax credit is allowed up to 20% of costs for household-related services. Also, 20% of the wage costs for craft services, such as repairs or renovations, can be offset with income tax.

Italy: Tax incentives are linked to purchases of vouchers which covers a broad range of services.

Measures Targeting Underreporting

Deterrent measures for sellers

To counter frauds whereby electronic cash registers (ECR) or electronic point-of-sale (POS) systems are often manipulated and altered to underreport sales, several countries have dictated ways to maintain sales registers. Ireland in July 2008 mandated that electronic cash registers record and retain sales entries in electronic format with uniquely identifiable sequential number, date, and time.

The government also issued guidelines for proper record keeping. In countries such as Argentina, Brazil, Bulgaria, Greece, Hungary, Latvia, Lithuania, Malta, Poland, the Russian Federation, Turkey, Venezuela, and Canada Quebec, usage of certified Point-of-sale (PoS) machines to prevent cash receipt skimming by installing monitoring devices in PoS machines has been increasingly made mandatory.

Incentive measures for customers

Another approach countering underreporting fraud is incentivizing customers to request receipts from businesses. Taiwan, China, in 1951 introduced 'receipt lottery' whereby they provided incentive in the form of lottery prize to request receipts from businesses.

Mainland China too introduced mandatory lottery receipts in all tax bureaus in 2009 after successfully experimenting in 80 big city level bureaus. In 2011, Puerto Rico Introduced sales-and-use tax lottery. Sao-Paulo, Brazil Introduced direct incentives in the form of VAT receipt rebates whereby on collecting receipts, end-customers can avail tax rebates on the VAT paid by the final sales establishment.

Apart from these, the paper also mentions some normative measures such as increasing tax education and tax awareness, enhancing tax morale and cultivating a compliance culture among citizens. Building citizen's trust regarding tax administrations and policies is also important.

Korea's Attempt to Reduce Under-reporting in Retail Business

The paper mentions that as part of the country's domestic resource mobilization programme, Korean tax authorities have adopted several measures to increase tax revenue and enhance tax equity by broadening the tax base. Emergence of National Tax Service (NTS) as an independent entity was to make tax revenue measures more effective to finance Korea's economic development plan. Korea also introduced global income tax on all incomes in 1975 and introduced VAT in 1977.

The paper further observes that the deterrent measures adopted by the authorities to increase tax compliance of both buyers and sellers have remained largely ineffective in Korea. At the same time policies pushing or encouraging tax compliance in businesses such as tax incentives for cash register receipts were also not effective. Normative policies such as awareness campaigns by industry bodies and consumer NGOs did not have the desired result. This failure led to a policy shift in Korea whereby end-consumers were encouraged to use more electronically traceable payment means for purchases.

This helped the tax authorities access more reliable sales data for cash-intensive businesses. Tax Incentives for Electronically Traceable Payments (TIETP) introduced in 1999 was considered as one of such policies for tackling cash transactions.

About TIETP

TIETP offers tax deductions from taxable labour income on using card based transactions. To avail this wage earners have to present their credit card transaction report issued by the respective banks and an application form to NTS via their employers. The tax deductions have a maximum and minimum limit. To avoid double deductions, incomes from business and real estate rent, insurance premiums paid to public insurance funds as well as tuition and entrance fees paid to public and private regular educational institutions were not included in TIETP. Also areas/activities for which underreporting was not a problem including national and local taxes and utility payments etc. were also kept outside the purview of TIETP.

After the introduction of TIETP, Korea also introduced electronically traceable cash receipts (ETCR) and made them an eligible form of electronic payment for TIETP in 2005. Consumers who may pay in cash can ask retailers for ETCR after providing all the personal identification details about them including mobile phone number and credit or debit card number, while the retailer issues the ETCR through its credit card payment terminal, thereby making even the cash payments traceable by NTS.

TIETP has also been expanded to B2C mobile phone transactions by allowing purchase of goods and services using credit cards and debit cards in mobile phones. NTS has also made several efforts to re-inforce its mobile tax service. These include

- Mobile tax related certificate issuing service has been provided by NTS since 2005
- A newsletter was started by NTS in 2014 which provides tax news and information on tax returns and payment notifications and tax legislations and rulings
- A mobile home tax service was also started by NTS in 2015.

Impact of TIETP

The paper finds that TIETP has had substantial impact on cashless payments since its introduction in 1999. Cashless payments as a percentage of Korea's GDP increased steeply from 4.9% in 1999 to 42.5% in 2014.

Ratio of tax payers to business income in Korea also substantially rose from 50% in early 2000 to 86.4% in 2014. This increase has been partially attributed to TIETP.

The paper also analyses the effective personal income tax rate trends in Korea to show that TIETP has effectively increased tax base for self-employed businesses thereby increasing tax revenue. Additionally it has reduced the tax burden on wage earning individuals.

The paper also finds that TIETP has overall positive impact on income redistribution due to broadened tax base although higher income people received greater tax reliefs due to progressive tax structure.

Conclusion

In its conclusion, the paper makes a number of recommendations for countries pursuing a similar incentive structure as TIETP to capture cash based businesses. These include:

- The need for a robust legal framework and tax information system to enable authorities, access financial transaction information.
- The tax rebate application process must be made easy and should guarantee assured return.
- The size of the tax incentive should be such that the revenue foregone effect should not exceed the revenue gains.
- The authorities should take into account the financial literacy of the country and the technological preparedness of its financial sector before implementing a similar programme.
- Retail vendors should be encouraged to install electronic point of sale machines by lowering cost of installation and credit card fees.
- The paper cautions that TIETP might lead to credit-card based over-consumption which may have a distortionary effect. The policy makers should account for this while making the policy.
- The paper finally urges that given that tax deductions benefits the higher income groups more due to progressive tax structure, tax credits as a format of TIETP are worth reviewing as a policy alternative.

Microfinance Sector

The Indian microfinance industry has recovered well post the Andhra Pradesh crisis that hit the sector in 2010, derailing its growth momentum to some extent, initially. After a phase of consolidation that lasted till FY2013, the sector has rebound to witness significant growth between FY2014 and FY2016. The growth has largely been aided by a favorable policy environment which has been created to further strengthen the regulatory framework for the sector and revive its growth. Several policy measures have been undertaken including changes in multiple lending norms, caps on margin and interest rates, etc., which have prompted microfinance institutions (MFIs) redefine their nature of operation, which in turn has led to a complete overhaul of the sector.

The sector has witnessed an all-round development with the number of microfinance institutions, quantum of credit extended by them, their ticket sizes and client outreach all having grown considerably over the past few years. Nearly 166 MFIs that are currently operating in India have been able to expand their reach to approximately 39 million people spread across 29 states, 4 Union Territories and 588 districts through their vast network, consisting of 11,644 branches and over one lakh employees (as of 2015-16). Pradhan Mantri MUDRA Yojana (PMMY)and the Atal Pension Yojana have also provided additional financial instruments for MFIs which have helped the sector expand substantially.

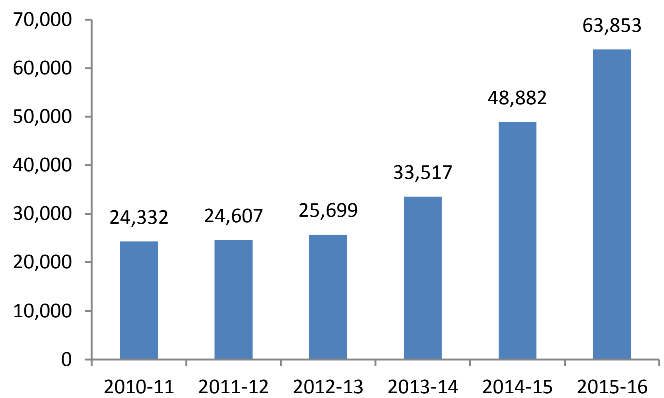
Thus, with this growth, the sector has also contributed immensely towards furthering the national agenda of financial inclusion in the country. Factors like access to rural poor; greater understanding of issues specific to a region due to limited geographical area focus; greater acceptance amongst the rural poor, have further helped MFIs achieve this feat.

MFI sector on fast track since 2013

During the three-year period ending 2015-16, client outreach of the sector has shown expansion of about 13.2% (CAGR), while gross loan portfolio and loans disbursed by MFIs have grown at a remarkable CAGR of 35.4% and 41% to Rs. 63,853 crore and Rs. 72, 345 crore respectively.

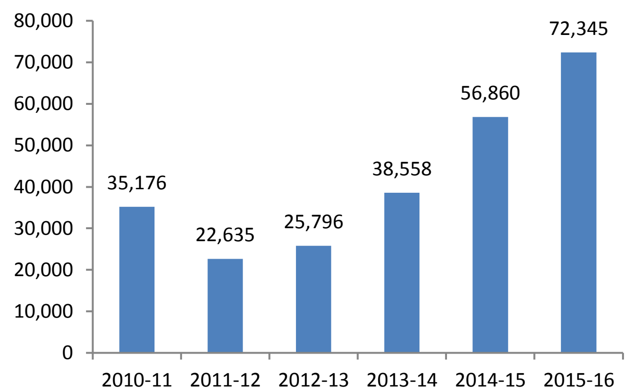
Over 2014-15, the client outreach grew by 8% to 399 lakh in 2015-16 and loan outstanding grew at a higher rate of 31%. However, between 2014-15 and 2015-16, total loan disbursed showed a lower growth of 27.2%.

Chart 1: Gross Loan Portfolio (Rs. Crore)



Source: The Bharat Microfinance Report 2016 by Sa Dhan

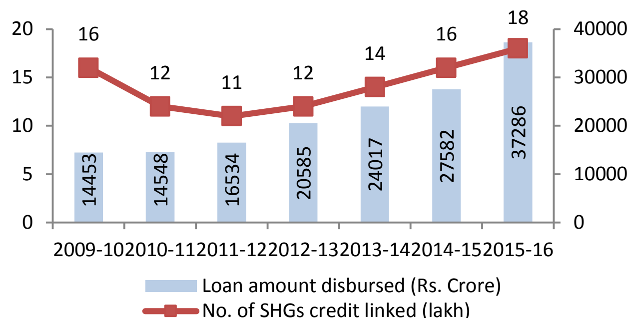
Chart 2: Loans Disbursed (Rs. Crore)



Source: The Bharat Microfinance Report 2016 by Sa Dhan

The Indian microfinance sector primarily operates through two channels – MFIs and Self Help Groups (SHGs), with NBFC-MFIs contributing the dominant share, accounting for about 85% of the total client outreach and as high as 88% of the outstanding portfolio of the sector. Since 2010-11, however, there has been steady increase in the number of SHGs linked to credit and bank loans extended to SHGs.

Chart 3: SHG-Trend in credit linkage and bank loan disbursed



The year 2016 in particular has been an eventful year for the sector. It witnessed MFIs access more capital with some of them getting listed on the bourses, more deals (acquisitions) in the space, and some MFIs commencing operations as small finance banks. Of the ten MFIs that hold licenses for small finance banks, 7 of them have commenced operations including Equitas Small Finance Bank and Capital Small Finance Bank, amongst others, while the other three are preparing to start operations.

Enabling factors for growth

There are multiple factors which have lent support to the growth of MFIs in India. The important among these include the following:

Supportive regulatory and policy framework

The Government of India along with the Reserve Bank of India (RBI) have undertaken steps to provide conducive policy and regulatory environment for the MFIs to facilitate uninterrupted growth of these entities realizing the critical role that they could play to reach the country's financial inclusion goals. The measures include RBI guidelines on NBFCs-MFIs; inclusion of loans to MFIs by banks under priority sector lending; limits and margin cap and interest cap on individual loans; tenure of loans; repayment schedules, amongst others. Based on the legal registration and nature of activities undertaken by the MFIs, various statutory requirements and lending norms have been established to facilitate their growth. The details are captured in the tables given below.

Table 1: Regulations

Parameter	Regulation/ Norm
Net owned funds	NBFC-MFIs require minimum net owned funds of Rs. 5 crore, (North Eastern region is Rs. 2 crore
Capital Adequacy	NBFC – MFIs maintain a capital adequacy ratio consisting of Tier I and Tier II Capital which shall not be less than 15 % of its aggregate risk weighted assets.
Qualifying Asset	NBFC-MFIs require to maintain not less than 85% of its net assets in the nature of qualifying assets.
Multiple Lending	Not more than two NBFC-MFIs shall lend to the same borrower

Table 2: Lending norms

Parameter	Regulation/ Norm
Household annual income	Rural: Rs.1,00,000 Urban & Semi-urban: Rs.1,60,000
Loan ticket size shouldnot exceed	Rs.60,000 in the first cycle and Rs. 1,00,000 in subsequent cycles
Total indebtedness of borrower	Should not exceed Rs. 1,00,000
Tenure of the loan	Not less than 24 months
Repayment	Repayable on weekly, fortnightly or monthly installments
Interest rate	The average base rate of five largest commercial banks multiplied by 2.75 per annum or cost of funds plus margin cap of 10% for MFIs having loan portfolio above Rs. 100 crore and 12% for those with loan portfolio less than Rs.100 crore. Overall rate of interest charged by any MFI to its borrowers shall not exceed 26% under Priority Sector Lending norms
Processing Charges	Not be more than 1% of gross loan amount

To provide further support to MFIs, microfinance credit bureaus have been launched by Equifax Credit Information Services (Equifax) and High Mark Credit Information Services (now known as CRIF Highmark), while status of a Self-Regulatory Organization (SRO) has been given to entities like MFIN in 2014 and Sa-Dhan in 2015. The Credit Bureaus collate credit data (loans availed, payment history, others) of microfinance borrowers from MFIs, which aids in mitigating challenges faced by microfinance sector including information asymmetry, chances of over-indebtedness due to multiple borrowings. All NBFC-MFIs have been mandated to be members of at least one of the CIBs and one SRO to ensure credit checks and process adherence, respectively. This helps in reducing risks, costs and default rates among the MFIs. These initiatives together have helped the sector observe an orderly growth.

Enhanced access to capital from Banks [Bank's interest in MFIs]

Attracted by the healthy growth recorded by MFIs in recent years, banks (largely private sector banks) and NBFCs have evinced interest in MFIs. Moreover, access to large customer base of MFIs (at bottom of the pyramid); constant (continuous) customer connect; favorable metrics (lower NPAs, high return on equity); and the potential for banks to extend their retail lending products (individual credit, mortgage finance, insurance) to MFIs are some of the other factors which have drawn banks towards the MFIs.

Banks have resorted to either investing in MFIs through acquiring a minority stake in them or through complete acquisition of these institutions. For instance, RBL Bank and DCB Bank have taken 10% stake in Utkarsh Microfinance and 5.81% stake in Annapurna Microfinance respectively. On the other hand, Kotak Mahindra Bank and IDFC Bank have acquired BSS Microfinance and Grama Vidiyal Micro Finance respectively. Besides, banks have also been lending directly to MFIs or through business correspondents to meet their priority sector lending targets (norms). The public sector banks too have increased their exposure to MFIs through bank correspondents.

This has provided MFIs access to much needed capital for disbursement.

Lowering of interest rates

Greater access to capital has also helped MFIs (especially larger ones) bring down their interest rates in recent years. Lower interest rates have also been the result of MFIs' ability to raise funds at lower costs; diversify borrowing mix in favor of debt market instruments; raise funding from refinance agencies like MUDRA Bank; and improve credit profile supported by rating upgrades leading to further lowering of credit costs. Increased competition in the sector has also prompted MFIs decrease interest rates to lure customers. The reduction in interest rate has been in the range of 100-500 bps with rates offering by top MFIs falling in the range of 19.75% -26%. The top 10 NBFC-MFIs with a contribution of 80% of the sector's Gross Loan Portfolio or over Rs. 40,000 crore had a weighted average interest rate of 23.13%, far below the 26% max cap under PSL guidelines.

Technology adoption

Microfinance lenders are adopting technology enabled solutions to improve process efficiencies. A case in point is the use of tablet based loan origination solutions which have aided the lender improve its productivity, but also improved the service quality for the customer by lowering the turnover time. Adoption of technology is enabling the lenders to check credit history of a customer on a real-time basis and decide on how much to lend thus enabling consistency and minimizing reviewer's subjectivity for the consumer.

It has also aided in lower transaction costs. Though some concerns still remain as small and medium-sized MFIs may have limited access to required capital needed to invest in technology and may adopt low-cost locally developed solutions which may not have the best industry practices embedded. In addition, infrastructural issues including lack of electricity and broadband connectivity could hamper technology adoption by MFIs concentrated in rural and semi-rural areas.

Moving towards urban areas

In an attempt to reduce operational expenses and maximize operational efficiency and maintain reasonable profitability, MFIs are adopting urban centric business models.

This is evident from the fact that the share of urban clients to rural clients in 2015-16 was 62% to 38% as compared to 31% and 69% respectively in 2011-2012. In 2015-16, loans disbursed in urban areas grew by 27%, accounting for around 71% of loans disbursed by MFIs, while those in rural areas were higher by 14%.

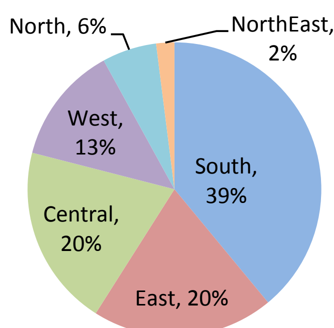
Challenges/ concerns faced by the microfinance industry

Though the microfinance industry has recorded handsome growth in the last two years, to maintain the growth story, the sector would need to overcome some challenges (internal and external) that it faces.

Regional imbalance/Geographical concentration risk

The geographical spread of the Microfinance industry has expanded in recent times; however, geographical concentration continues to remain a risk and challenge as they are more vulnerable to internal and external shocks. The larger MFIs have expanded their reach over higher number of states to reach size and scale and also to mitigate concentration risk, while the smaller MFIs have a more regional focus. Around 48% (79 MFIs) have confined their operations to only one state while 38% of MFIs operate in around 2-5 states. Some states which have a larger share of the poor, the coverage by MFIs is relatively low.

Chart 4: Regional Break-up of Client outreach



The southern region has a greater concentration of MFI in terms of branches and clientele. Geographical concentration exposes the MFIs to risk arising out natural calamities (droughts, floods and earthquakes) and also to risk to political activism (MFI customers are more politically sensitive). Geographical expansion would aid to mitigate these risks however; it would increase operational challenges for the MFIs.

Human resource

MFIs require adequately skilled and efficient work force, as it is highly labor intensive and involves interaction with individuals and handling of cash. Literacy levels especially financial literacy levels of the target customers are relatively low and borrowers need to be financially educated and trained on how to manage their debt.

In addition, another challenge for the workforce is recovering timely payments from the customers given the largely relatively unstable nature of the client's cash flows. As most of the MFIs are expanding, the sector witnesses churning as larger MFIs are better positioned to offer better compensation packages as compared to medium and small size MFIs. The industry faces a high attrition rate of (~25%). MFIs also need to provide appropriate training to its workforce and incur substantial training costs.

Operational efficiency – cash handling

Majority of the transactions undertaken by the MFIs are cash driven and cash handling at a large scale impacts operational efficiency. Operational challenges include higher costs due to transporting and safekeeping charges (interest foregone, insurance premium, higher security manpower costs); time spend on cash counting and reconciliation; scheduling of meetings keeping the banking hours in mind; possibility of frauds, irregular accounting, misappropriations, fake currency, amongst others.

Switching to digital payments mode can aid MFIs mitigate the risk involved in dealing with cash, while customers could adopt safer and secure ways of making payments, including mobile wallets.

Multiple lending and over indebtedness

Over-indebtedness is currently one of the most important challenges in microfinance. Some major factors responsible for this are multiple borrowings, high debt-service burden, discrepancy between stated purpose and actual usage of loans, inflexibility in repayment schedules, and pipeline loaning .

According to the observation shared by the CRIF High Mark Credit Information Services, by December 2016, microfinance borrowers with top-up loans had an average exposure of Rs. 45,400, which is more than double the national average of Rs. 22,000 and around 17% of the customers with top-up loans were servicing five loans at a time with around 1.26 million microfinance borrowers having received top-up loans over and above their existing loan amounts. While this number is small considering the overall MFI borrowers (about 40 million), it however is a cause for concern. Another concern is the treatment of loan exposure to small finance banks and MFIs. As per regulations, a borrower cannot borrow money from more than two MFIs at a time. Seven of the MFIs with small finance bank licenses have commenced operations, while four others are expected to begin operations soon. Since they now technically classify as different entities, small borrowers may be able to raise fresh loans from other MFIs which could lead to overleveraging.

Impact of discontinuation of high value currency notes

The December 2016 quarter has witnessed a 26% decline in number of loans disbursed by MFIs and a 16% drop in amount of loan disbursed. This is largely due to the cash shortage and limits on cash withdrawal following the discontinuation of high value currency notes on 8 November 2016. Cash crunch and overleveraging among borrowers and the impact of demonetisation is impacting the asset quality of MFIs in the near term. The delinquencies in the MFI loan books are rising. Microfinance loan collection has come down to around 85% as compared to around 99% prior to demonetisation . As per reports portfolio at risk (PAR) for MFIs has shot up to 7.52% in the December 2016 quarter from around 0.5% in the previous quarters as a result of lower recoveries. This has also led to downgrading of outlook on MFIs by rating agencies.

In the wake of cash crunch following demonetisation, RBI permitted MFIs an additional 90 days to classify loans as NPAs, if payments were due between 1 November and 31 December 2016. For MFIs, a loan is classified as NPA if principal and interest are overdue for 90 days or more. Despite this, MFIs have witnessed an increase in stress levels.

There are concerns that MFIs would find it difficult to recover multiple installments from borrowers. Microfinance institutions Network (MFIN), representative body for microfinance institutions is considering seeking a 6-month extension of repayment tenure for loans stuck on account of demonetisation, as against the earlier request for a 3-month extension from RBI. The sector is expected to wring out these issues in the medium term.

Shift towards cashless/digital transactions

The thrust away from cash transactions and towards digital transactions is a major challenge for MFIs. The low penetration of banks/ATMs in rural areas, low proportion of smart phone users especially women who constitute 97% of the total clientele of MFIs, lack of comfort with usage of mobile phone for purposes other than voice calls and messages given the complex interfaces are some of the impeding factors. Customers have to be provided training to familiarize with other modes of payment other than cash.

The accounts opened under the Pradhan Mantri Jan DhanYojana (PMJDY) would aid in this transition. In the medium to long term, shift towards digital mode of transactions would bring in greater transparency, enhance the risk management system and also aid in cutting down on transaction costs.

Outlook for the sector

The microfinance sector is expected to recover and fare well in the medium-long term. Conducive policy and regulatory environment as well as quicker adoption of technology to aid shift towards digital mode of payment/transaction would support growth and efficiency of the industry. On the lenders part, product diversification, customization of loan products and self-discipline would aid growth while keeping the potential risks at bay.

Note: This article is largely based on 'The Bharat Microfinance Report 2016' published by Sa-Dhan.

Survey Highlights

Business Confidence Survey, April 2017

Source: FICCI Business Confidence Survey, April 2017

Overall Business Confidence Index moved up by almost 10 points in the present round and stood at 68.3 – which is the highest in eight quarters. Results pertaining to the current situation as well as expectations for the next six months report a distinct improvement.

Proportion of respondents citing current economic conditions as 'moderately to substantially better' relative to previous two quarters increased to 54% in the present round vis-à-vis 25% stating likewise in the previous round. Additionally, near term expectations of the respondents pointed towards greater buoyancy. About 79% of the companies participating in the survey cited 'moderately to substantially better' performance at the economy level vis-à-vis 64% stating likewise in the last round.

The survey results highlight considerable improvement in the confidence level of corporate India which is reassuring. This is despite an uncertain global environment and new risks remaining on the anvil. Amidst this situation, it remains important to keep up the momentum on domestic reforms and take these forward by focusing on their timely implementation.

Feedback on operational parameters shows mixed results - while a pick up is anticipated in case of sales, employment and profits; outlook on parameters such as exports indicates weakening. Investment intentions continue to remain tepid and this remains one of the biggest economic concern at the moment. Even though the government has been pushing public investments; a turnaround in the domestic private capex cycle is needed to support growth and jobs.

About 40% of the participating companies indicated that they foresee higher investments over the next two quarters. The corresponding figure in the previous round was 44%. Nonetheless, some improvement was reported in the capacity utilization rate of companies. In the present round, 45% of the participating companies indicated that they are operating at over 75% capacity vis-à-vis 40 % stating likewise in the previous round.

Moreover, participating companies felt that it could still take some time for the pricing power to return to corporates. Respondents believe that capacity utilization is still sub optimal. Even though demand situation is gradually improving, majority of the respondents felt that it will take about 9 months to 12 months for pricing power to return.

Further, 61% of the respondents cited rising cost of raw materials as a key constraining factor. Global commodity prices have been firming up for quite some time. Crude oil prices (Europe Brent) have edged by over 30% over the past one year and metal prices (indexmundi metal price index) by over 25%. On the other hand, proportion of respondents citing weak demand and availability and cost of credit as a concern declined in the current survey round.

The survey sought responses on the extent to which companies were planning to shift towards digitization given greater government focus on the same. About 69% of the companies participating in the survey said they are introducing changes in their organization towards greater use of digital modes/digitalization for transactions.

The current survey drew responses from companies with a wide sectoral and geographical spread. The survey drew responses from about 185 companies with a turnover ranging from Rs 11 crores to Rs 11,700 crores. The participating companies belonged to an array of sectors such as textiles, real estate, hospitality, steel, oil & gas, agricultural equipment, food processing, chemicals, FMCG, IT & telecom and electronic products.

FICCI

For detailed report you may contact:
Economic Affairs and Research Division
Email: researchdivision@ficci.com

Economy Fact Sheet – GDP
March 2017

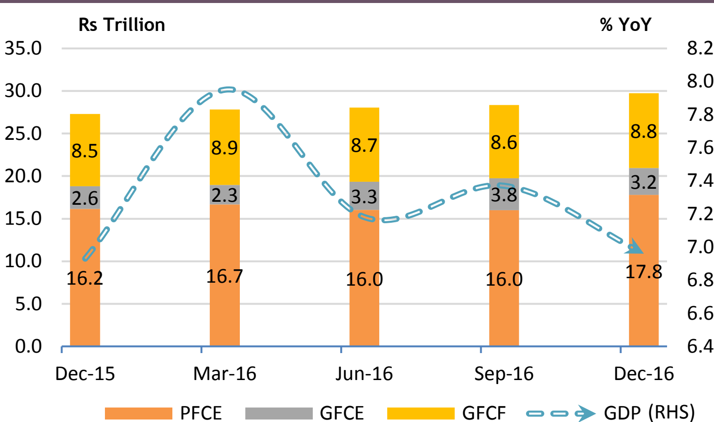
GDP grew by 7.0 percent in Q3 FY17

- *India's Gross Domestic Product at market prices reported a growth of 7.0 percent in Q3 FY17 as compared to 6.9 percent growth reported in the corresponding period previous year. GVA at basic prices grew by 6.6 percent in Q3 FY17 as compared to 7.0 percent growth reported in Q3 FY16.*

- *Sectoral classification reveals strong growth of 6.0 percent in agriculture and allied services in Q3 FY17. The corresponding number previous year was (-) 2.2 percent. Good monsoon in 2016 has been a major support to the sector. Manufacturing also recorded robust growth of 8.3 percent in Q3 FY17. However, a slowdown in construction and financial services, real estate & business services sectors pulled down the overall services growth to 6.8 percent in Q3 FY17 which was the lowest since March 2014.*

- *Annual estimate for 2016-17 has been revised to 7.1 percent. Likewise, growth for 2015-16 was revised to 7.9 percent from 7.6 percent reported earlier.*

Quarterly GDP Growth- by Expenditure



Broadly all parameters on the expenditure side displayed an improved performance. The growth was led by government expenditure which grew by almost 20.0 percent in Q3 FY17. Private consumption also reported a strong growth of 10.1 percent during this quarter.

It needs to be noted that the improved GDP growth in Q3 FY17 was also supported by a downward revision in Q3 FY16 numbers (primarily led by a downward revision in private consumption expenditure growth to 6.8 percent from 8.2 percent reported earlier).

Further, gross fixed capital formation reported 3.5 percent growth in third quarter of FY17 after reporting decline for three consecutive quarters.

GDP & GVA Growth (% YoY)

	Q3 FY16	Q4 FY16	Q1 FY17	Q2 FY17	Q3 FY17	2015-16*	2016-17#
GDP at market prices	**6.9**	8.0	7.2	7.4	**7.0**	7.9	**7.1**
GVA at basic prices	**7.0**	7.4	6.9	6.7	**6.6**	7.8	**6.7**
Agriculture, forestry and fishing	**-2.2**	2.3	1.9	3.8	**6.0**	0.8	**4.4**
Industry	**9.5**	7.9	6.1	5.1	**6.6**	8.2	**5.8**
Manufacturing	**12.8**	9.3	9.0	6.9	**8.3**	10.6	**7.7**
Services	**9.4**	8.8	8.8	8.2	**6.8**	9.8	**7.9**

*First Revised Estimates; # Second Advanced Estimate

Widespread expectations of sub 7.0 percent growth in 2016-17 have been set aside with the Central Statistics Office putting the growth forecast at 7.1 percent for the entire fiscal year. With the process of remonetisation almost over, economic activity is gathering pace. However, it is extremely critical to push the domestic capex cycle which has been persistently weak. We are hopeful that going ahead, the planned increase in public expenditure will crowd in private investments.

Further, Union Budget 2017-18 emphasized on strengthening the demand pulse in the economy by focusing on farmers, the broader rural sector and the youth. This is expected to sustain and aid growth. Also, the Indian Meteorological Department's forecast of a near normal monsoon bodes well for agricultural growth prospects in 2017-18.

Source: MOSPI, RBI, Economic Outlook, CMIE, and FICCI Research

Economy Fact Sheet – Balance of Payments
March 2017

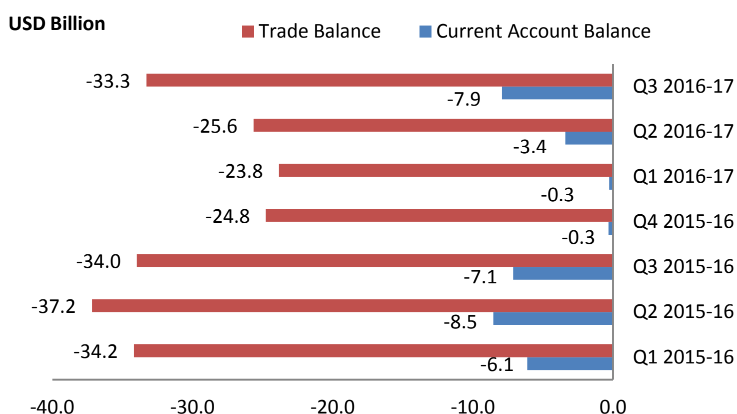
CAD stood at 1.4 percent of GDP in Q3 FY17

- *India's Current Account Deficit (CAD) increased to USD 7.9 billion in Q3 2016-17 as compared to USD 7.1 billion in Q3 2016-17. As a percent of GDP, CAD stood at 1.4 percent in Q3 2016-17 which was the same as that reported in the corresponding quarter previous year.*

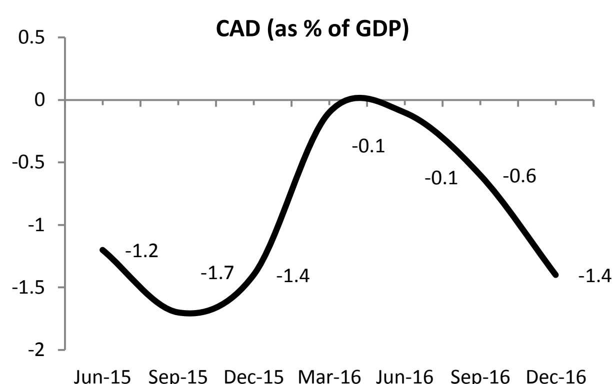
- *Net foreign direct investment stood at USD 9.8 billion in Q3 of 2016-17. This was slightly lower than USD 10.7 billion reported in Q3 of 2015-16. There was a net outflow of portfolio investment to the tune of USD 11.3 billion as against net inflow of USD 0.6 billion in Q3 of last year; portfolio outflows occurred in both equity and debt segments.*

- *According to RBI, foreign exchange reserves stood at USD 358.9 billion at the end of the third quarter of 2016-17.*

Snapshot of trends in India's Current Account Balance



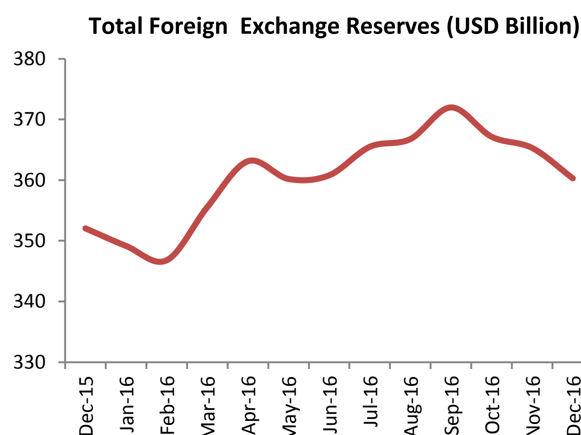
Current account as % to GDP (base year 2011-12)



Balance of Payments- Key Indicators

USD Billion	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17	Q2 FY17	Q3 FY 17
Current account	-8.5	-7.1	-0.3	-0.3	-3.4	-7.9
Goods	-37.2	-34.0	-24.8	-23.8	-25.6	-33.3
Net Invisible Receipts	28.6	26.8	24.4	23.5	22.2	25.3
Financial Account	8.9	6.8	0.14	0.02	4.2	7.4
Foreign Direct Investments	6.5	10.7	8.8	3.8	16.9	9.8
Foreign Portfolio Investments	-3.5	0.6	-1.5	2.1	6.1	-11.3

Forex Reserves



- In Q3 2016-17, the CAD widened primarily on account of a decline in net invisibles receipts (y-o-y) basis. Net services receipts also fell down due to moderation in earnings from software exports, financial services and charges for intellectual property rights.

- Capital outflows were observed in Q3 2016-17 on the back of net outflow of portfolio investments and decline in NRI deposits due to redemption of three year FCNR (B) deposits that matured during this period.

- On a cumulative basis, the CAD has narrowed to 0.7 percent of GDP in April-December 2016 from 1.4 percent in the corresponding period of 2015-16. As per FICCI's latest Economic Outlook Survey too, CAD is expected to remain under control at 0.7 percent of GDP for the year 2016-17.

Source: RBI, Economic Outlook CMIE

Economy Fact Sheet – Index of Industrial Production
April 2017

IIP contracted by 1.2 percent in February 2017

- *Index of Industrial Production contracted by 1.2 percent in February 2017 after witnessing 3.3 percent growth in the previous month. All major sectors reported weak growth during the month. On a cumulative basis, the index reported weak growth of 0.5 percent during April-February 2017 vis-à-vis 2.6 percent growth reported in the corresponding period previous year.*

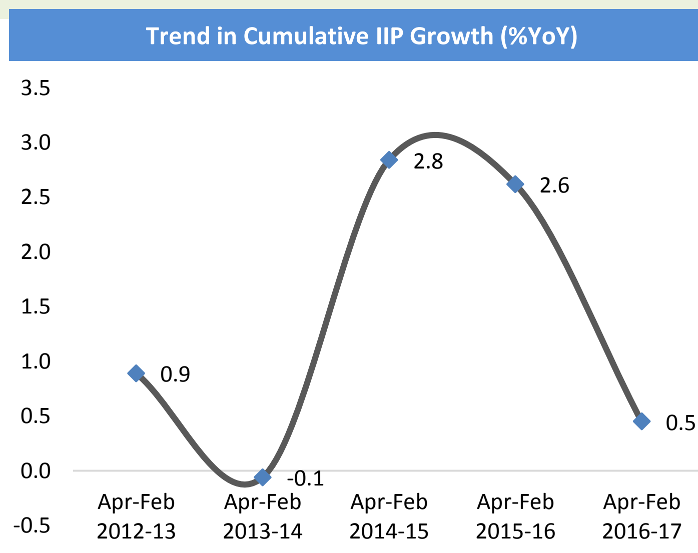
- *Index for manufacturing sector declined by 2.0 percent in February 2017 as compared to 2.9 percent growth registered in the previous month. Mining activity, too, dropped to four month low of 3.3 percent in February 2017. Electricity generation reported a growth of 0.3 percent in February 2017 which is the lowest in six months. Thermal electricity, the largest component with around 90 percent share in total electricity generation, reported 0.3 percent contraction during the month.*

- *As per use based classification of industrial production, basic goods noted 2.4 percent growth in February 2017 as compared to 5.2 percent growth noted in the previous month. All other segments - intermediate goods, capital goods and consumer goods - reported contraction in February 2017. While the growth in intermediate goods fell by 0.2 percent, growth in capital goods declined by 3.4 percent during the month. Production of consumer goods also witnessed a decline owing to a fall in output of consumer durables and consumer non-durables. Consumer durables contracted by 0.9 percent in February 2017 vis-à-vis 6.7 percent growth in January 2017. Consumer non-durables performed worse, recording a fall of 8.6 percent in February 2017.*

Industrial Performance- Monthly (% YoY)

% growth rate	Feb-16	Nov-16	Dec-16	Jan-17	Feb-17
Index of Industrial Production	1.9	5.6	-0.1	3.3	-1.2
Sectoral					
Mining	5.0	4.0	5.5	5.3	3.3
Manufacturing	0.6	5.4	-1.7	2.9	-2.0
Electricity	9.6	8.9	6.3	3.9	0.3
Use-base industry classification					
Basic goods	5.4	4.8	5.5	5.3	2.4
Capital goods	-9.3	14.3	-3.9	10.9	-3.4
Intermediate goods	4.9	2.4	-1.3	-2.0	-0.2
Consumer durables	10.4	9.4	-8.9	6.7	-0.9
Consumer non- durables	-4.9	2.6	-4.4	-3.0	-8.6

Trend in Cumulative IIP Growth (%YoY)



- Growth in the index of industrial production has been volatile since November 2015. The poor performance can be attributed to the fragile growth witnessed in manufacturing.

- Additionally, latest data on investments by CMIE reveals that announcement of new investment was the second lowest in 2016-17 since 2004-05 despite efforts to pep up investment activity. Investment proposals to add new capacities declined by 17.7 percent to 2461 projects during the year. In terms of value, total fresh investments declined by 2.5 percent to Rs. 7.8 trillion in 2016-17. This was the second consecutive year when the total investment value has moderated.

- This calls for continuous efforts towards making the sector more competitive, going forward.

New Investments by Ownership

Years	Rs.in trillion			Count (nos.)		
	Total	Govt	Private	Total	Govt	Private
2012-13	5.1	1.8	3.3	2,893	1,164	1,729
2013-14	6.0	3.3	2.7	2,464	1,263	1,201
2014-15	10.2	4.8	5.4	2,840	1,277	1,563
2015-16	8.0	2.5	5.5	2,992	1,352	1,640
2016-17	7.8	2.2	5.6	2,461	1,189	1,272

Source: MOSPI, Economic outlook CMIE and FICCI Research

Economy Fact Sheet – Inflation
April 2017

WPI eases to 5.7 percent in March 2017

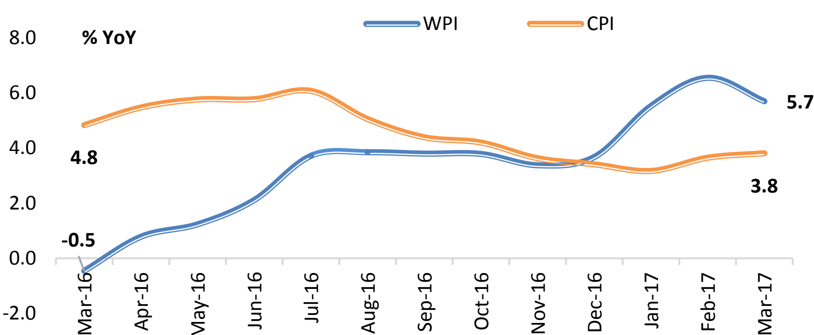
- *WPI based inflation eased to 5.7 percent in March 2017 after rising sharply for three consecutive months. Prices of primary articles and manufactured products noticed moderation during the month.*

- *After peaking in July 2016, WPI based food inflation has been on a downtrend. However, the index has noted an uptick for two straight months in February and March 2017. It stood at 3.1 percent in March 2017 owing to higher fruits and vegetables prices.* Prices of fruits and vegetables increased by 6.8 percent in March 2017 as compared to 0.5 percent inflation recorded in the previous month. *Prices of non-food articles eased to 4.9 percent in March 2017 vis-à-vis 6.5 percent inflation reported in the previous month.*

- *Even though the rise in prices of fuel and power was a tad lower in March 2017 vis-à-vis February 2017, the segment continued to witness elevated prices. The index reported an inflation rate of 18.2 percent in March 2017 as compared to 21.0 percent inflation noted in February 2017. In March 2017, prices of petrol and high speed diesel rose by 20.6 percent and 26.2 percent y-o-y respectively. Inflation in manufactured products moderated to 3.0 percent in March 2017 as against 3.6 percent inflation reported in February 2017. This is the second consecutive month when the price pressure of the index cooled.*

- *Retail CPI inflation inched upwards to 3.8 percent in March 2017 vis-à-vis 3.7 percent inflation noted in the previous month. CPI food inflation, however, eased slightly to 1.9 percent in March 2017 from 2.0 percent inflation reported in the previous month.*

Trend in CPI and WPI Inflation



Measures to address wastage and supply concerns

The Government has been taking measures to reduce wastage of fruits and vegetables and improve supply management to reign in food prices. Recent measures announced to deal with this include:

1. Approval to set up 101 cold chain projects to reduce wastage.
2. Setting a target of linking 400 of the 585 wholesale mandis with e-NAM by March 2017.

On an annual basis, WPI based inflation noticed an increase in 2016-17 and stood at 3.7 percent for the entire fiscal year as compared to a deflation of 2.5 percent reported in 2015-16. The rise can be attributed to higher food and fuel inflation during the year. On the other hand, prices of pulses, which have been a major concern, have cooled significantly in 2016 and are now on a deflationary path. The government had offered incentives, such as higher minimum support price and bonus, to farmers to boost domestic production of pulses. As a result, India was able to produce a record 22.1 thousand tonnes of pulses in 2016-17.

However, evolving weather conditions calls for greater monitoring. The government is keeping vigil on the progress of irrigation and cold chain projects which is likely to yield positive results. Focus on drip and micro irrigation techniques coupled with enhanced efficiency of cropping patterns and water use mechanisms is expected to strengthen agricultural production, going forward.

Key WPI Components (% change Y-o-Y)

	Mar-16	Jan-17	Feb-17	Mar-17
Primary articles	3.0	2.3	5.0	4.6
Food articles	4.1	-0.2	2.7	3.1
Fruits & Vegetables	-2.3	-14.8	0.5	6.8
Pulses	34.4	6.2	-0.8	-6.1
Fuel and power	-8.3	18.1	21.0	18.2
Manufactured products	0.1	4.0	3.7	3.0

Key CPI Components (% change Y-o-Y)

	Mar-16	Jan-17	Feb-17	Mar-17
Food and beverages	5.2	1.4	2.4	2.5
Fruits	-1.1	5.8	8.3	9.4
Pulses	34.2	-6.6	-9.1	-12.4
Clothing & footwear	5.5	4.7	4.4	4.6
Housing	5.3	5.0	4.9	4.9
Fuel & light	3.5	3.3	3.9	5.6

Source: MOSPI, PIB, Economic Outlook – CMIE and FICCI Research

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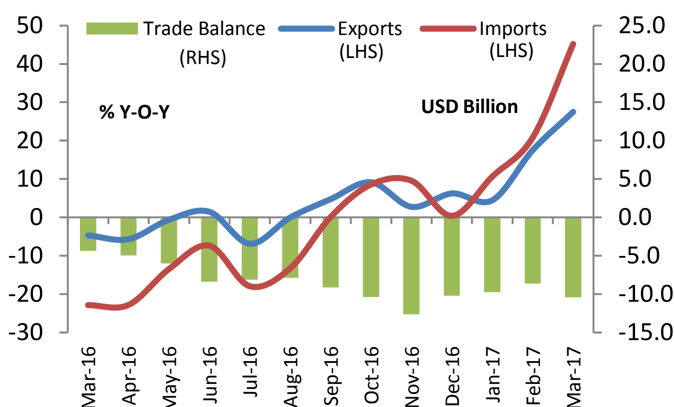
Economy Fact Sheet – Foreign Trade
April 2017

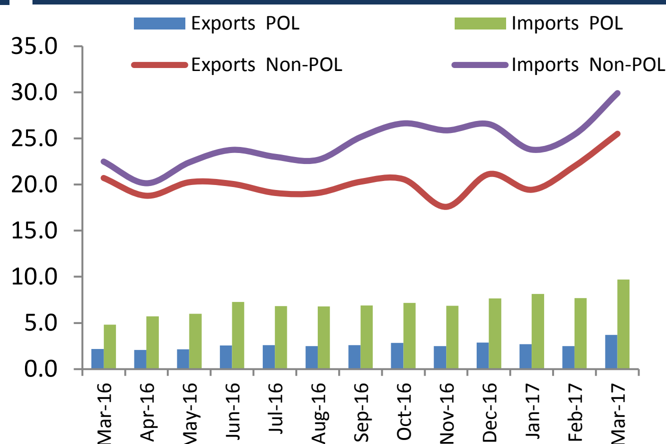
Trade deficit stood at USD 10.4 billion in March 2017

- *India's trade deficit stood at USD 10.4 billion in March 2017. Trade deficit for the year 2016-17 was estimated at USD 105.7 billion which was 10.9% lower than the deficit of USD 118.7 billion recorded during the year 2015-16.*
- *March was the seventh consecutive month when merchandise exports reported growth. On a cumulative basis, India exported goods worth USD 274.6 billion in 2016-17, 4.7% higher than USD 262.3 billion reported in 2015-16.*
- *For the month of March, exports were valued at USD 29.2 billion and imports stood at USD 39.6 billion. Both merchandise exports and imports registered a growth of 27.6 per cent and 45.2 percent respectively. Exports of petroleum products witnessed a growth of 69.0 percent while non-petroleum exports products grew by 23.1 percent on a y-o-y basis. Oil imports were valued at USD 9.7 billion, which was 101.4 percent higher than oil imports of USD 4.8 billion recorded in March 2016. Similarly, gold imports were also seen rising by 328.9 percent in March 2017 as against a contraction of 80.5 percent noted in the corresponding month previous year.*

Trend in India's Merchandise Trade



Oil- Non Oil Trade (in USD Billion)



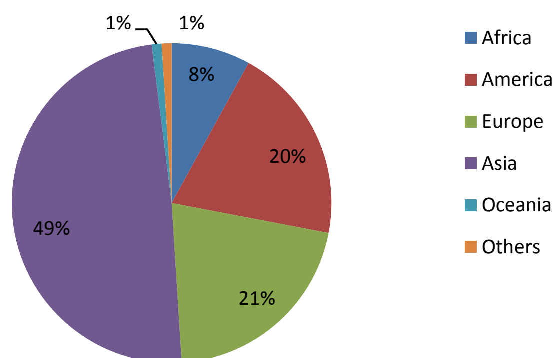
According to the World Trade Organization (WTO), world merchandise trade grew by 1.3 percent in 2016 and is forecasted to grow higher at 2.4 percent in 2017.

For India too, exports prospects could be positive on account of higher economic growth projected in 2017 for some of its key export destinations. For instance, as per the World Bank's Global Economic Prospects, USA (which accounts for over 15% of India's merchandise exports) is projected to grow at 2.2% in 2017, up from 1.6% in 2016. However, the downside risk could emanate from unpredictable trade policies in the US and some other advanced markets.

In-fact, some of the multilateral declarations (G-20 and IMF), have recently dropped reference to anti-protectionism, which has traditionally been adopted in previous years.

India should continue to have bilateral trade dialogues with the US administration to ensure that our exports of goods and services are not adversely impacted by the new trade policies.

India's Top Export Destinations (% Share) (Apr-Feb, 2016-17)



Top Export Items in 2016-17 (April-Feb)	% Share
Engineering Goods	24.3
Petroleum & crude products	11.2
Gems & Jewellery	15.6
Readymade Garments (RMG)	6.3
Drugs, Pharmaceuticals	6.1

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

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FICCI Economic Affairs and Research Division

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***