ECONOMIC SURVEY – 2014-15: SUMMARY

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What is holding back private investment?: A combination of factors

- ✓ weak corporate balance sheets,
- ✓ an impaired banking system,
- ✓ difficulty of exit,
- ✓ the deficiencies of the public private partnership (PPP) model in infrastructure.

Private investment must remain the main engine of long-run growth. But, in the short to medium term, as the near-intractable problems get slowly resolved, public investment, especially by the railways, will have to play a catalytic role.

Reforms that can be brought about: some important reforms such as

- ✓ improvements to tax administration or
- ✓ easing the cost of doing business,

Reforms require persistence and patience in their implementation, evoked in Max Weber's memorable phrase, "slow boring of hard boards".

India needs to follow what might be called ***"a persistent, encompassing, and creative incrementalism"*** but with bold steps in a few areas that signal a decisive departure from the past and that are aimed at addressing key problems such as ramping up investment, rationalizing subsidies, creating a competitive, predictable, and clean tax policy environment, and accelerating disinvestment. Thus, Weber's wisdom cannot be a licence

Definition: Employment elasticity of growth: that is, a given amount of growth leads to fewer jobs created than in the past.

Reform Actions of the New Government Since assuming office in May 2014, the new government has undertaken a number of new reform measures whose cumulative impact could be substantial.

- ✓ Deregulating diesel prices, paving the way for new investments in this sector;

- ✓ Raising gas prices from US$ 4.2 per million British thermal unit to US$ 5.6, and linking pricing, transparently and automatically, to international prices so as to provide incentives for greater gas supply and thereby relieving the power sector bottlenecks;

- ✓ Taxing energy products. Since October, taking advantage of declining oil prices, the excise tax on diesel and coal was increased four times. In addition to resulting in collections of about `70,000 crore (on an annualized basis), this action will have positive environmental consequences

- ✓ Replacing the cooking gas subsidy by direct transfers on a national scale;

- ✓ Instituting the Expenditure Management Commission, which has submitted its interim report for rationalizing expenditures;
- ✓ Passing an ordinance to reform the coal sector via auctions;
- ✓ Securing the political agreement on the goods and services tax (GST) that will allow legislative passage of the constitutional amendment bill;

- ✓ Instituting a major program for financial inclusion—the Pradhan Mantri Jan Dhan Yojana under which over 12.5 crore new accounts have been opened till mid-February 2014;
- ✓ Continuing the push to extending coverage under the Aadhaar program, targeting enrollment for 1 billion Indians; as of early February, 757 million Indians had been bio-identified and 139-Aadhaar linked bank accounts created;

- ✓ Increasing FDI caps in defense;

- ✓ Eliminating the quantitative restrictions on gold;

- ✓ Passing an ordinance to make land acquisition less onerous, thereby easing the cost of doing business, while ensuring that farmers get fair compensation;

- ✓ Facilitating Presidential Assent for labour reforms in Rajasthan, setting an example for further reform initiatives by the states; and consolidating and making transparent a number of labour laws; and

- ✓ Passing an ordinance increasing the FDI cap in insurance to 49 percent.

- ✓ Commencing a program of disinvestments under which 10 percent of the government's stake in Coal India was offered to the public, yielding about `22,500 crore, of which `5,800 crore was from foreign investors;

- ✓ Passing the Mines and Minerals (Development and Regulation) (MMDR) Amendment Ordinance, 2015 is a significant step in revival of the hitherto stagnant mining sector in the country. The process of auction for allotment would usher in greater transparency and boost revenues for the States.

Going forward, this momentum is likely to persist because of three striking developments in three areas that signal a structural shift in the inflationary process in India: crude-oil, agriculture, and inflation expectations. A rule of thumb is that a US$10 reduction in the price of oil helps improve the net trade and hence current account balance by US$ 9.4 billion.

Agriculture: What should be the focus ?

- ✓ In the medium-term, the time is ripe for a more broad-based response to the challenges in agriculture and to ensure that agriculture grows at about 4 percent on a sustained basis.
- ✓ Rationalisation of subsidies and better targeting of beneficiaries through direct transfers would generate part of the resources for the public investment
- ✓ There are also wide differences in the yields within states. Even the best of the states have much lower yield in different crops when compared to the best in the world.
- ✓ Vast amounts of cropped area (approximately 41 percent) are still unirrigated. Providing irrigation can improve yields substantially.
- ✓ To provide efficient advance price-discovery to farmers and enable them to hedge price risks the Forward Markets Commission is being strengthened.

Fiscal Consolidation

- ✓ The 'golden rule' of eliminating revenue deficits and ensuring that, over the cycle, borrowing is only for capital formation. Second, the way to achieve these targets will be expenditure control and expenditure switching from consumption to investment.

- ✓ GST is implemented, the consequential tax buoyancy when combined with expenditure control will ensure that medium term targets can be comfortably met
- ✓ In the upcoming year, too, fiscal consolidation must continue. However, the need for accelerated fiscal consolidation has lessened because macro-economic pressures have significantly abated with the dramatic decline in inflation and turnaround in the current account deficit.

Poverty

- ✓ No nation can become great when the life chances of so many of its citizens are benighted by poor nutrition, limited by poor learning opportunities, and shriveled by gender discrimination
- ✓ *A recent study found strikingly that merely informing families in villages outside Bangalore that call centres were hiring educated women increased the likelihood that adolescent girls in those villages completed schooling*
- ✓ To be successful, anti-poverty programs must recognise that policies shape the incentives of individuals and firms, and also acknowledge the limited implementation capacity of the state to target and deliver public services to the poor.

Subsidies

- ✓ The estimated direct fiscal costs of these (select) subsidies are about `378,000 crore or about 4.2 percent of GDP.
- ✓ For many subsidies, only a small fraction of the benefits actually accrue to the poor.
- ✓ Different subsidies also interact to hurt the poor. For example, fertiliser manufacturers do not have the incentive to sell their product in hard-to-access regions, since price controls mean that prices are similar everywhere, so freight subsidies on railways have been introduced to incentivise manufacturers to supply their produce widely.
- ✓ But those subsidies are sometimes insufficient, since freight rates are among the highest in the world, and intentionally so, to cross-subsidise artificially low passenger fares. This is an example of how a mesh of well-meaning price controls distort incentives in a way that ultimately hurt poor households.
- ✓ High minimum support for rice and wheat distort crop choice, leading to water-intensive cultivation in areas where water tables have been dropping

like a stone, and ultimately induce greater price volatility in non-MSP supported crops which hurts consumers, especially poor households who have volatile incomes and lack the assets to weather economic shocks. High MSPs also penalise risk-taking by farmers who have ventured into non-traditional crops.

- ✓ JAM number trinity, rural India could witness both the creation of opportunity and protection of the vulnerable.

But increasing capital flows are yet to translate into a durable pick-up of real investment, especially in the private sector Why?. This owes to at least five interrelated factors that lead to what the Mid-Year Economic Analysis called the "***balance sheet syndrome with Indian characteristics***."

- ✓ First, hobbled by weak profitability and weighed down by over-indebtedness, the Indian corporate sector is limited in its ability to invest going forward (the flow challenge). One key indicator of profitability—the interest cover ratio, which if less than one implies firms' cash flows are not sufficient to pay their interest costs—has also worsened in recent years

- ✓ the debt-equity ratios of the top 500 non-financial firms have been steadily increasing, and their level now is amongst the highest in the emerging market world.

- ✓ Second, weak institutions relating to bankruptcy means that the over-indebtedness problem cannot be easily resolved
- ✓ Third, even if some of these problems were solved, the PPP model at least in infrastructure will need to be re-fashioned to become more viable going forward (the institutional challenge).
- ✓ Fourth, since a significant portion of infrastructure was financed by the banking system, especially the public sector banks, their balance sheets have deteriorated. Banking is hobbled by policy, which creates double financial repression, and by structural factors, which impede competition. The

Solution lies in the 4 Ds of :

- ✓ ***deregulation*** (addressing the statutory liquidity ratio (SLR) and priority sector lending (PSL)),
- ✓ ***differentiation*** (within the public sector banks in relation to recapitalisation, shrinking balance sheets, and ownership),
- ✓ ***diversification (***of source of funding within and outside banking), and
- ✓ ***disinterring*** (by improving exit mechanisms).

The problems in the Indian banking system lie elsewhere and fall into two categories: policy and structure.

- ✓ The policy challenge relates to financial repression. The Indian banking system is afflicted by what might be called ***"double financial repression***" which reduces returns to savers and banks, and mis-allocates capital to investors. Financial repression on the asset side of the balance sheet is created by the statutory liquidity ratio (SLR) requirement that forces banks to hold government securities, and priority sector lending (PSL) that forces resource deployment in less-than-fully efficient ways. Financial repression on the liability side has arisen from high inflation since 2007
- ✓ The structural problems relate to competition and ownership.
- ✓ private sector in overall banking aggregates barely increased at a time when the country witnessed its most rapid growth and one that was fuelled by the private sector. It was an anomalous case of private sector growth without private sector bank financing.
- ✓ Second, there is wide variation in the performance of the public sector banks measured in terms of prudence and profitability.

Solution to the problems in banking sector:

- ✓ Easing SLR requirements will provide liquidity to the banks, depth to the government bond market, and encourage the development of the corporate bond market.
- ✓ Second, PSL norms too can be re-assessed. There are two options: one is indirect reform bringing more sectors into the ambit of PSL, until in the limit every sector is a priority sector; and the other is to redefine the norms to slowly make PSL more targeted, smaller, and need-driven.
- ✓ There must be differentiation between the PSBs and the recent approach to recapitalization adopted by the government is a step in the right direction. One size fits all approaches such as governance reform cannot be the most appropriate. Differentiation will allow a full menu of options such as selective recapitalization, diluted government ownership, and exit.
- ✓ "Diversify" implies that there must be greater competition within the banking system, including liberal licensing of more banks and different types of banks. There must also be greater competition from capital, especially bond, markets. Facilitating that will require exiting from asset side repression, namely the phasing down of the SLRs which would also help develop bond markets.

- ✓ "Disinter" implies that exit procedures must become more efficient. Debt Recovery Tribunals are over-burdened and under-resourced, leading to tardy resolution. The ownership structure and efficacy of Asset

Restructuring Companies, in which banks themselves have significant stakes of banks, creates misaligned incentives. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act seems to be implemented most vigorously against the smallest borrowers and MSEs. Mechanisms for distributing pain efficiently amongst promoters, creditors, consumers, and taxpayers without creating moral hazard incentives for imprudent lending by banks are necessary. One important lesson is that the clean-up is as important as the run-up.

Five important characteristics of a sector that can transform the economy can be identified as:

- ✓ High levels of productivity, so that incomes can increase;
- ✓ Rapid rate of growth of productivity in relation to the world frontier (international convergence) as well as rapid growth toward the national frontier (domestic convergence);
- ✓ A strong ability of the dynamic sector to attract resources, thereby spreading the benefits to the rest of the economy;
- ✓ Alignment of the dynamic sector with a country's underlying resources, which typically tends to be unskilled labor; and
- ✓ Tradability of the sector, because that determines whether the sector can expand without running into demand constraints, a feature that is important for a large country like India.

Unregistered manufacturing cannot be a transformational sector. Thus, efforts to encourage formalization will be critical

One policy conclusion that follows is that efforts to improve the conditions for labor-intensive manufacturing need to be complemented with rapid skill upgradation because skill-intensive sectors are dynamic sectors in India and sustaining their dynamism will require that the supply of skills keeps pace with the rising demand for these skills; otherwise even these sectors could become uncompetitive. In other words, the Prime Minister's Skill India objective should be accorded high priority along with, and indeed in order to realize, "Make in India"

Giving manufacturing a boost

- ✓ The uncontroversial responses consist of improving the business environment by making regulations and taxes less onerous, building infrastructure, reforming labour laws, and enabling connectivity– all these would reduce the cost of doing business, increase profitability, and hence encourage the private sector, both domestic and foreign, to increase investments. Indeed, these measures would not just benefit manufacturing, they would benefit all sectors.

- ✓ The next set of responses—what might loosely be called "industrial policy"—would target the promotion of manufacturing in particular: providing subsidies, lowering the cost of capital, and creating special economic zones (SEZs) for some or all manufacturing activity in particular.

- ✓ The final set of responses—what might be called "protectionist"—would focus on the tradability of manufacturing, and hence consist of actions to: shield domestic manufacturing from foreign competition via tariffs and local content requirements; and provide export-related incentives. The effectiveness of these actions is open to debate given past experience. Moreover, they would run up against India's external obligations under the WTO and other free trade agreements, and also undermine India's openness credentials.
- ✓ There is one response that would help manufacturing and the "Make in India" initiative without being as difficult as improving the business environment, and as controversial and expensive as the industrial policy or protectionist response: eliminating the exemptions in the countervailing duties (CVD) and special additional duties (SAD) levied on imports. Why will this help?

How should India react to this global shift in trade realities?

- ✓ It has two choices: ***measured integration (the status quo and/or RCEP) or ambitious integration (via the TPP).***

- ✓ Measured integration would involve a slow but steady pace of domestic reform dictated by India's political constraints and capacity which could only sustain regional agreements of the kind India has negotiated with Asian partners: relatively few obligations, generous exemptions and exceptions, and lenient timetables for implementation. The risk in the status quo scenario is one of India being excluded from large integrated markets with reduced trading possibilities, and because of the nature of global value chains in which trade, investment, and intellectual property are enmeshed, also reduced investment possibilities. (Joining RCEP might help but not fully since the expectation is that the overall standards in RCEP will be weaker than under the TPP and TTIP).

- ✓ There will not only be the standard diversion emanating from Indian exporters having to face higher tariffs in large, growing markets, but increasingly they will have to contend with different and higher product and sustainable development standards, placing them at an even greater disadvantage. In the context of the slowdown in both world growth and India's export buoyancy, any possible exclusion from the mega-regionals would be additionally worrisome.

- ✓ Ambitious integration would essentially mean India joining, or rather seeking to join, at some future date the TPP. There is considerable uncertainty surrounding this option because the timing and terms of the TPP are still unclear. What is clear, however, is that the substantive liberalization obligations under any future TPP will be greater than those under India's current FTAs and probably ahead of India's planned pace of domestic reform. A significant upgrading of Indian trade capability will be necessary for India to be able to join these mega-regionals should it chose to do so.

What can be done to avoid bilaspur like tragedies?

- ✓ Bilaspur Tragedy : 97.5% female , 2.5% male sterilization.
- ✓ By not setting targets (ELAs or expected levels of achievement), withdrawing incentives for female sterilization and for mass camps. In addition, the government could: (i) Review the family planning program in India and reorient it such that it is aligned with reproductive health rights of women, and needs of India's population. (ii) Increase budgets for quality services, static family planning clinics and quality monitoring and supervision. (iii) Address youth needs, induct more counsellors for sexual health, more youth-friendly services, and adequate supply of spacing methods. (the financing challenge)

Medium tern fiscal policy:

- ✓ Accordingly, the medium-term fiscal strategy should be based on two pillars. First, the fiscal deficit should be reduced over the medium-term to the established target of 3 percent of GDP. Second, and mindful of the experience of the past decade, efforts to achieve this objective should be based on firm control over expenditures, most notably by eliminating leakages in subsidies and social expenditures. Further, switching from public consumption (via the rationalisation of subsidies) to public investment will, for any given level of overall spending, mitigate long-run inflationary pressures because the latter will add to capacity and boost the aggregate supply potential of the economy. Also, asset sales to finance investment is consistent with boosting growth without adding to aggregate demand pressures in the short run.

'Wiping every tear from every eye': the JAM Number Trinity Solution

Subsidies:

- ✓ Price subsidies are often ***regressive.***
- ✓ For a start consider price subsidies in electricity. Note first that these subsidies can only benefit the (relatively wealthy) 67.2 percent of households that are electrified. 4 Second, note that even among
- ✓ electrified households, richer households (predictably) use much more power:
- ✓ Fuel subsidies can be similarly regressive.
- ✓ The story is similar when one just considers subsidies for Liquefied Petroleum Gas (LPG). From the table we note the striking fact that the ***poorest 50 percent of households consume only 25 percent of LPG.***
- ✓ At first glance, kerosene seems a good candidate for price subsidies as it is popularly conceived to be consumed mostly by the poor. Yet, as Table 3.1 shows, only 46 percent of total consumption of subsidised kerosene is by households with a Below Poverty Line (BPL) or Antyodaya Anna Yojana (AAY) card6 , and only 49 percent is consumed by households in the bottom 3 deciles of the expenditure distribution. Popular perception is thus partly correct: poor households are indeed more likely to use kerosene than rich households, but a majority (51 percent) of subsidised kerosene is consumed by the non-poor and almost 15 percent of subsidised kerosene is actually consumed by the relatively well-off (the richest 40 percent).
- ✓ Subsidised water is almost as regressive as subsidised heat and light. Table 3.1 shows that a large fraction of price subsidies allocated to water utilities – by one estimate up to 85 percent 7 – are spent on subsidising private taps when 60 percent of poor households get their water from public taps
- ✓ Controlled rail prices actually provide more benefits for wealthy households than poor households, since the bottom 80 percent of households constitute only 28.1 percent 9 of total originating passengers on non-suburban rail routes.
- ✓ It is not just commodity subsidies that are sometimes regressive; subsidised services can be as well.
- ✓ Subsidies can distort the incentives of consumers and producers, and result in misallocation of resources across sectors and firms, which lowers aggregate productivity and often disproportionately hurts the poor and vulnerable
- ✓ ges are falling though still unacceptably high 12 . There is also suggestive evidence that leakages are larger in the APL rather than the BPL category

- ✓ A recent study reported evidence from Andhra Pradesh where MGNREGA and Social Security payments were paid through Aadhaar-linked bank accounts. Households received payments on average 10 days faster with the new Aadhaar-linked direct benefits transfer system, and leakages reduced by 10.8 percentage points. The value of the fiscal savings – due to lower leakages – were 8 times greater than the cost of implementing the program. This shows the high returns to public investments in the state capacity required to deliver secure payments. In addition to net fiscal savings, income transfers can compensate consumers and producers for exactly the welfare benefits they derive from price subsidies without distorting their incentives in the way described

- ✓ We describe two alternative financial delivery mechanisms below:

    - Mobile Money– With over 900 million cell phone users and close to 600 million unique users, mobile money offers a complementary mechanism of delivering direct benefits to a large proportion of the population. 370 million of these cell phone users are based in rural areas, and this number is increasing at a rate of 2.82 million every month.

    - Post Offices –India has the largest Postal Network in the world with over 1,55,015 Post Offices of which (89.76 percent) are in the rural areas. Similar to the mobile money framework, the Post Office (either as payment transmitter or a regular Bank) can seamlessly fit into the Aadhaar linked benefits-transfer architecture. The post office network also enjoys a long-standing reputation of using its deep network to serve many geographically isolated consumers in the country.

Stalling of projects:

- ✓ A more granular analysis shows that ***manufacturing, mining and electricity***, in that order, have had the highest stalling rates in the last few quarters among all sectors
- ✓ we analyse primary reasons for stalling in public and private sectors. It is clear that ***private projects are held up overwhelmingly due to market conditions and non-regulatory factors whereas the government projects are stalled due to lack of required clearances***.
- ✓ First manufacturing is being stifled by a general deterioration in the macroeconomic environment. Second, stalled projects in electricity are a victim of lack of coal (or coal linkages).
- ✓ Finally what is the distribution of the value of stalled projects? They are top heavy in the sense that a small fraction accounts for a bulk of the total value of stalled projects. Table 4.6 shows that clearing the top 100 projects by value will address 83 per cent of the problem of stalled projects. This makes the problem look relatively manageable.

Interest Coverage Ratio (ICR). ICR is technically defined as the ratio of a company's earnings before interest and taxes (EBIT) of one period to its interest expenses over the same period.

- ✓ Tying things together- a steep decline in gross fixed capital formation, a large volume of projects in suspended animation, worryingly high number of stressed assets in banks' balance sheets and a highly leveraged corporate sector- suggests that Indian firms face a classic debt overhang problem in the aftermath of a debt fuelled investment bubble, translating into a balance sheet syndrome with Indian characteristics.

- ✓ The biggest lesson from stalled projects and the associated credit aided infrastructure bubble is that perhaps more than a run up problem (over exuberant and misdirected private investment), we face a clean-up problem (bankruptcy laws, asset restructuring, etc.). Creative solutions are necessary for distributing pain equally amongst the stakeholders from past deals gone sour.
- ✓ An idea to fix the clean-up problem is setting up of a high powered Independent Renegotiation Committee.
- ✓ Many infrastructure projects are today financially stressed, accounting for almost a third of stressed assets in banks. New projects cannot attract sponsors, as in recent NHAI bids, and banks are unwilling to lend. Given its riskiness, pension and insurance funds have sensibly limited their exposure to these projects. This current state of the public private partnership (PPP) model is due to poorly designed frameworks, which need restructuring.

Flaws in existing design of PPP:

- ✓ First, existing contracts focus more on fiscal benefits than on efficient service provision. For example, in port and airport concessions, the bidder offering the highest share of gross revenue collected to the government is selected. Thus, if this share is 33% (higher in many actual contracts), the user pays 50% more than what is required, since the concessionaire is able to provide service even though it gets only ` 1 for every ` 1.50 charged.

- ✓ Second, they neglect principles allocating risk to the entity best able to manage it. Instead, unmanageable risks, e.g., traffic risk in highways, even though largely unaffected by their actions, are transferred to concessionaires. This is also true for railways and in part, for ports (though inter-terminal competition is possible) and airports.

- ✓ Third, the default revenue stream is directly collected user charges. Where this is deemed insufficient, bidders can ask for a viability grant, typically disbursed during construction. This structure leaves the government with no leverage in the case of non-performance, with few contractual remedies short of termination. Fiscal reporting practices also affect this choice. Current accounting rules treat future committed expenditure as a contingent liability. However, foregone future revenue is not accounted for.

- ✓ Fourth, there are no ex-ante structures for renegotiation. If a bureaucrat restructures a project, there are no rewards; instead it may lead to investigation for graft. Failed projects lead neither to penalties nor investigation. With such asymmetric incentives, bureaucrats naturally avoid renegotiation.
- ✓ Finally, contracts are over-dependent on market wisdom, e.g., bidders in ultra-mega power projects (UMPP) could index tariff bids to both fuel prices and exchange rates, but almost all chose very limited indexation. When fuel prices rose and the rupee fell, these bids became unviable. To enforce market discipline and penalise reckless bidding, these projects should have been allowed to fail. Needed Modifications Despite such flaws, PPP generated significant investment. Can these flaws be rectified in a country, like India, which is reluctant to let concessionaires fail?

What should future contracts look like?

- ✓ First, it is better to continue combining construction and maintenance responsibilities to incentivise building quality. In many projects, especially highways, maintenance costs depend significantly on construction quality. If a single entity is responsible for both construction and maintenance, it takes lifecycle costs into account. Separating these responsibilities provide an incentive to increase profits by cutting corners during construction. Suggestions to let the public sector build assets and have the private sector maintain and operate them ignore this linkage.

- ✓ Second, risk should only be transferred to those who can manage it. In a highway or a railway project, it is not sensible to transfer usage risk since it is outside the control of the operator. But, it can be done in telecom projects and for individual port terminals that compete with each other, where demand can respond to tariff and quality.
- ✓ Third, financing structures should be able to attract pension and insurance funds, which are a natural funding source for long-term infrastructure projects.

What does this mean for key sectors?

- ✓ First, rather than prescribe model concession agreements, states should be allowed to experiment. For example, in ports, terminals can be bid on the basis of an annual fee, with full tariff flexibility, subject to competition oversight. For electricity generation, bids can be two-part, with a variable charge based on normative efficiency, or alternatively, determined by regulators and a capacity charge.

  Another option, without that drawback, is the Least Present Value of Revenue (LPVR)a contract, where the bid is the lowest present value (discounted at a pre-announced rate) of total gross revenue received by the concessionaire. The concession duration is variable and continues until the bid present value amount is received. A key advantage of this contract is that it converts usage risk to risk of contract duration, which is more manageable for financial institutions. Since the bid is on gross revenue, it also selects bidders who can execute at low cost and demand relatively lower margins and by limiting the scope for renegotiation to the remaining uncollected value of the LPVR bid, it discourages opportunistic bidding. Further, since the present value is protected, this structure is suitable for pension and insurance funds.

- ✓ Restructuring of existing contracts Revival of private interest and bank lending needs existing contracts to be restructured, with burden sharing among different stakeholders. Lenders may have extended credit without necessary due diligence, assuming that projects were implicitly guaranteed. Without burden sharing, this behaviour will be reinforced. Similarly, many bidders may have assumed that they could renegotiate in the event of negative shocks. Thus, there was potentially adverse selection of firms who felt they had the capacity to renegotiate; rather than firms better at executing and operating the project. In particular, this may have limited participation by foreign firms. In the absence of burden sharing, such adverse selection would be supported.

  Thus, the guiding principle should be to restructure contracts based on the project's revenues, differentiating between temporary illiquidity and insolvency. For example, all stressed highway projects could be switched to electronic tolling. All revenues can go, as now, into an escrow account, but with a revised order of priority. Long-term bullet bonds, at the risk-free government rate, can be issued to the extent of the debt in the project. After operations and maintenance, interest payments on these bonds, which may also be guaranteed by the Union government, will be first in order of priority. Lenders can opt to switch existing debt to these bonds. Allocations for repayment of their principal will have second priority and existing debt that has not been switched, the next priority. Equity can be the residual claimant. If the project makes money over its lifetime, equity holders will earn a return, though some may exit now, at a discount. The private sector remains key to rapid delivery of high quality infrastructure. Restructured PPP frameworks will revive their interest in infrastructure and bring in funding from pension and insurance funds.

Phasing out of SLR

- ✓ The SLR is a form of financial repression where the government pre-empts domestic savings at the expense of the private sector. Real interest rates are lower than they would be otherwise. Recently, the RBI has taken commendable and gradual steps in lowering the SLR from 25 per cent to 21.5 per cent. The question is whether the ambitions in this area should be ratcheted up. Three developments make this question particularly salient.

- ✓ The argument has always been that SLRs can only be reduced if the government's fiscal situation improves. That is only partly correct because stocks rather than flows should condition SLR reform. India's fiscal deficit situation still needs consolidation but the public debt situation has been steadily improving and will continue to improve because of India's growth and inflation compared to borrowing costs. Overall indebtedness (center and states) has declined from over 80 percent to 60 percent in a decade. And this trend will continue because favorable debt dynamics will continue to operate in the future as long as growth remains above 8 percent. This creates the first opening for phasing down the SLR over time.

- ✓ To be sure the government's borrowing costs will go up but the magnitudes are likely to be small for two reasons: first, costs will rise only on debt that is maturing, which over the next five years is about 21.1 per cent of total outstanding debt; and second, the macro-environment and progress in durably reining in inflation may favor lower real interest rates.

- ✓ The second reason relates to the health of the banks. As interest rates decline, there is scope for capital appreciation for the banks that hold the bulk of government securities. SLR reductions could allow them to offload G-secs and reap the capital gains which could help recapitalise them, reducing the need for government resources, and helping them raise private resources. (This is a better and cleaner way of recapitalizing the banks than to allow banks to mark their G-secs to market and realize the accounting profits). To avoid any moral hazard issues, gains from recapitalization should go first towards provisioning against NPAs, and only the surplus should go towards being counted as capital.

- ✓ The third reason relates to the recent experience of infrastructure financing. PPP-based projects have been financed either by public sector banks or through foreign currency-denominated debt (ECBs). The former has proven tricky to say the least and the latter contributed to decline in corporate sector profitability especially in the infrastructure sector: investors borrowed in dollars and their revenues were predominantly in rupees so that when the rupee depreciated their profitability and balance sheets were adversely affected. The time is therefore ripe for developing other forms of infrastructure financing, especially through a bond market. But SLRs have also stymied the development of government bond markets which in turn stifles the development of corporate bond markets. Reducing SLRs are therefore critical to finding better sources of infrastructure financing. The end-point of reform should be to combine the SLR and the Capital to risk weighted assets ratio (CRAR) a into one liquidity ratio set at a desirable level depending on international norms.

Investment Issues:

- ✓ Increasing financial flows are yet to translate into a durable pick-up of real investment, especially in the private sector. This owes to a number of interrelated factors that stem from what has been identified as the "balance sheet syndrome with Indian characteristics."
- ✓ The International Monetary Fund (IMF), in the World Economic Outlook (October 2014) has noted that increases in public infrastructure investment, if efficiently implemented, affects the economy in two ways. In the short run it boosts aggregate demand and crowds in private investment due to the complementary nature of infrastructure services. In the long run, a supply side effect also kicks in as the infrastructure built feeds into the productive capacity of the economy.
- ✓ Indeed, the two biggest challenges facing increased public investment in India are financial resources and implementation capacity.
- ✓ As regards the latter, the trick is to find sectors with maximum positive spillovers and institutions with a modicum of proven capacity for investing quickly and efficiently. Two ***prime candidates are rural roads and railways***.
- ✓ The legacy of inadequate allocation is reflected in the fact that the share of railways in total plan outlay is currently only 5.5 per cent vis-à-vis about 11 per cent for the other transport sectors and its share in overall development expenditure has remained low at below 2 percent over the past decade. As a share of GDP, China has invested around three times as much as India on average over the period 2005-2012

- ✓ In per-capita terms, China has invested on average eleven times as much over the same period even though both countries have similar populations

What have been the consequences of such underinvestment for the Indian Railways? The first casualty has been capacity expansion.

- ✓ With lack of capacity addition, the share of railways in the GDP has declined to stand at around 1 per cent in recent years track expansion in the Indian railway has miserably lagged behind capacity addition in the domestic roads sector, study has estimated that the modal share in freight traffic stands at 36 per cent for the railways vis-à-vis 57 per cent for roads
- ✓ For example, the US has a 44 per cent share despite having extensive networks of coastal shipping links and elaborate inland waterways that carry significant freight

- ✓ According to the McKinsey Study (2010) continuation of the current state of affairs in India would imply the share of railways in freight traffic declining further to 25 percent by 2020.
- ✓ An efficient rail freight network can help industry to transport raw materials at lower costs and also with associated lower green house gas emissions, comparatively better energy efficiency, and reduced congestion.
- ✓ A second and related consequence has been congestion and stretching of capacity.

- ✓ For example, the speed of the average freight train has remained virtually constant between 2000-01 and 2012-13 at around 24-25 km/hour.
- ✓ On high density network (HDN) routes, over 65 per cent of total sections (161 out of 247) are running at a capacity of 100 percent or above
- ✓ For example, in the north central railways 96 percent of sections and in the south eastern railway about 75 percent of sections are operating at above full capacity. The NTDPC (2014) report argues that capacity utilisation of 80 per cent is the optimum

- ✓ as some slack in line capacity is necessary to absorb and recover from unforeseen disruptions in operations of trains.
- ✓ With passenger trains utilizing around 65 percent of the network capacity, the above situation imposes constraints on the running of heavy freight trains
- ✓ Over these years, data indicates that the load carried and distance travelled by a wagon per day and the turnaround time has almost stagnated.

- ✓ Based on 2007-08 data (the latest year for which the input-output tables are available), it appears that increasing the railway output by `1 would increase output in the economy by` 3.3. This large multiplier has been increasing over time, and the effect is greatest on the manufacturing sector. Investing in Railways could thus be good for "Make in India."

- ✓ Railways are found to posses strong backward linkages (demand pull from other sectors) with manufacturing and services. Based on 2007-08 data (the latest year for which the input-output tables are available), it appears that increasing the railway output by `1 would increase output in the economy by` 3.3. This large multiplier has been increasing over time, and the effect is greatest on the manufacturing sector. Investing in Railways could thus be good for "Make in India." Further, there are sectors where railway services are an input to production (forward linkages). A `1 push in railways will increase the output of other sectors by about` 2.5.

- ✓ China carries about thrice as much coal freight per hour vis-à-vis India. Coal is transported in India at more than twice the cost vis-à-vis China, and it takes 1.3 times longer to do so.

- ✓ Historically, there have been three modes of escape from under-development: geology, geography, and "jeans" (code for low-skilled manufacturing). In recent years West Asia, Botswana and Chile, and further back in time Australia and Canada, exploited their natural resources endowed by geology to improve their standards of living. Some of the island successes (Barbados, Mauritius, and others in the Caribbean) have exploited their geography by developing tourism to achieve high rates of growth. In the early stages of their success, East Asian countries (China, Thailand, Indonesia, Malaysia etc) relied on relatively low-skilled manufacturing, typically textiles and clothing, to motor economic growth. Later on they diversified into more sophisticated manufacturing but "jeans" offered the vehicle for prosperity early on.

In fact, building upon the Rodrik (2013) framework, it is argued that there are five attributes that allow a sector to serve as an engine of structural transformation and thereby lead an economy to rapid, sustained and inclusive growth:

- ✓ ***High level of productivity***:As described above, economic development is about moving from low productivity to high productivity activities.
- ✓ ***Unconditional Convergence***(i.e. faster productivity growth in lower productivity areas): This too has been discussed earlier. Recall that convergence ensures that the relevant sector acts as an "escalator" which automatically leads to higher levels of sectoral and economy-wide productivity. In fact one can distinguish between two types of unconditional convergence:
    - ▪ Domestic convergence: In large countries such as India, China, Brazil, and Indonesia, one would ideally like to see convergence withina

country. That is, productivity growth should be faster in richer than poorer parts. Otherwise severe within-country regional inequality may arise.

- International convergence: whereby less-productive economic units (firms, sectors or entire economies) in all countries catch-up with units at the international frontier (i.e. those in the most productive countries).

✓ ***Expansion:*** To ensure that the dynamic productivity gains from convergence spread through the economy, it is necessary that the sector experiencing convergence absorbs resources. Convergence accompanied by contraction will fail to ensure economy-wide benefits, because the country's resources that are outside the sector in question will not experience higher, convergent productivity growth. Convergence, in the case of the industrial sector, should be accompanied by natural industrialisation and not premature de-industrialisation, if it is to lead to truly inclusive growth.

✓ ***Alignment with comparative advantage***: To ensure that expansion occurs and the benefits of fast-growing sectors are widely shared across the labor force, there should be a match between the skill requirements of the expanding sector and the skill endowment of the country. For example, in a labour abundant country such as India, the converging sector should be a relatively low-skilled activity so that more individuals can benefit from convergence

✓ ***Tradability:*** Historically, countries that had growth spurts enjoyed rapid growth in exports, typically manufacturing exports. Rapid growth has seldom been based on the domestic market. Part of the reason for this might be that trade serves as a mechanism for technology transfer and learning, which may have spillovers on related industries. Perhaps a more important part is that trade and exports in particular provide a source of unconstrained demand for the expanding sector. This is particularly important for a country of India's size because of the possibility that its expansion can run up against the limited political and economic ability of trading countries to absorb Indian exports and/or to turn the terms of trade against itself

Several explanations are possible for why manufacturing has not been this escalator in India. They fall under four broad categories:

✓ distortions in labour markets;
✓ distortions in capital markets;
✓ distortions in land markets; and
✓ inappropriate specialisation away from India's natural comparative advantage and toward skill intensive activities.

Like manufacturing, several of the service subsectors also exhibit high productivity and convergence – both domestic and international. However, they also share the shortcoming that these sectors are highly skill intensive in their resource requirements, which is out of kilter with the skill profile of the Indian labor force. Their potential to generate widely shared or inclusive growth is thus likely to be limited – and indeed seems to have been so given the lack of expansion observed earlier. One sector that markedly stands out from the others in the table below is construction: it appears to exhibit both types of convergence, does not require high education levels and has grown significantly in its resource use over the last three decades. However, the sector is not tradable and in any case is low productivity, so that moving labor resources to the sector does not considerably improve overall welfare.

So, in some ways, the choice for India is not manufacturing versus services but comparative advantage deifying(unskilled-intensive) sectors versus comparative advantage defying(skill-intensive) sector development. This is both a positive and a policy question.

In some ways, the choice confronting India is really about how to make it a Lewisian economy that has unlimited supplies of labor. India can either create the conditions to ensure that its existing unlimited supplies of unskilled labor are utilisable. Or, it can make sure that the currently inelastic supply of skilled labor is made more elastic. Both are major challenges.

Agricultural markets:

- ✓ Effectively, India has not one, not 29 but thousands of agricultural markets.
- ✓ APMCS LEVY MULTIPLE FEES, OF SUBSTANTIAL MAGNITUDE, THAT ARE NON-TRANSPARENT, AND HENCE A SOURCE OF POLITICAL POWER
- ✓ Even the model APMC Act (described below) treats the APMC as an arm of the State, and, the market fee, as the tax levied by the State, rather than fee charged for providing services. This is a crucial provision which acts as a major impediment to creating national common market in agricultural commodities.
- ✓ Removal of this provision will pave a way for creating competition and a national common market for agricultural commodities. Moreover, though the market fee is collected just like a tax, the revenue earned by the APMCs does not go to the State exchequer and hence does not require the approval of State legislature to utilize the funds so collected. Thus APMC operations are hidden from scrutiny.

- ✓ The rate of commission charged by the licensed commission agents is exorbitant, because, unlike direct taxes, which are levied on net income, the commission is charged on the entire value of the produce sold. The license fee charged from various market licensed operators is nominal, but the small number of licences granted creates a premium, which is believed to be paid in cash.
- ✓ There is a perception that the positions in the market committee (at the state level) and the market board – which supervises the market committee - are occupied by the politically influential.
- ✓ The resistance to reforming APMCs is perceived to be emanating from these factors.

The Model APMC Act:-

- ✓ provides for direct sale of farm produce to contract farming sponsors;
- ✓ (b) provides for setting up "Special markets" for "specified agricultural commodities" mostly perishables;
- ✓ (c) permits private persons, farmers and consumers to establish new markets for agricultural produce in any area;
- ✓ (d) requires a single levy of market fee on the sale of notified agricultural commodities in any market area;
- ✓ (e) replaces licensing with registrations of market functionaries which would allow them to operate in one or more different market areas;
- ✓ (f) provides for the establishment of consumers' and farmers' markets to facilitate direct sale of agricultural produce to consumers; and
- ✓ (g) provides for the creation of marketing infrastructure from the revenue earned by the APMC.

The provisions of the Model APMC Act do not go far enough to create a national – or even state-level common market for agricultural commodities. The reason is that the model APMC Act retains the mandatory requirement of the buyers having to pay APMC charges even when the produce is sold directly outside the APMC area, say, to the contract sponsors or in a market set up by private individuals even though no facility provided by the APMC is used.

Steps to be taken:

- ✓ More steps may have to be taken and incremental moves may need to be considered to get the states on board. For example, first, it may be possible to get all the states to drop fruits and vegetables from the APMC schedule of regulated commodities; this could be followed by cereals, pulse and oil seeds, and then all remaining commodities. State governments should also be specifically persuaded to provide policy support for setting up infrastructure, making available land etc. for alternative or special markets in private sector, since the players in the private sector cannot viably compete with the APMCs in which the initial investment was made by the government on land and other infrastructure.

- ✓ Liberalisation of FDI in retail could create the possibilities for filling in the massive investment and infrastructure deficit which results in supply-chain inefficiencies.

- ✓ If persuasion fails (and it has been tried for a long time since 2003), it may be necessary to see what the center can do, taking account of the allocation of subjects under the Constitution of India. There are provisions/entries in List III of the Seventh Schedule (Concurrent List) in the Constitution which can be used by the Union to enact legislation for setting up a national common market for specified agricultural commodities

"I feel more and more that we must function more from below than from the top too much of centralization means decay at the roots and ultimately a withering of branches, leaves and flowers." -Pandit Jawaharlal Nehru

"We want to promote co-operative federalism in the country. At the same time, we want a competitive element among the states. I call this new form of federalism Co-operative and Competitive Federalism" - Prime Minister Narendra Modi

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- ✓ Central Statistics Office (CSO) has recently revised the national accounts aggregates by shifting to the new base of 2011-12 from the earlier base of 2004-05
- ✓ That this high growth occurred in a year when the both the savings and investment to GDP ratios were lower than the average of a number of years and when the level of imports (that are generally positively associated with GDP) actually declined by 8.4 per cent in real terms, is somewhat puzzling. One of the reasons why the real GDP growth rate for 2013-14 appears to be strong is the lower GDP level in 2011-12 and 2012-13 along with lower GDP deflators than were thought hitherto.
- ✓ A greater decline in the level of GDP in 2011-12 and 2012-13, has given an upward push to the growth rate in the 2013-14. On the other hand, the upward revision of inflation in 2012-13, measured by the GDP deflator, gave a downward push to growth, but not to the extent of nullifying the positive effect of relative revisions in absolute levels. In 2013-14, the downward revision in the deflator pushed up real growth in the new series.
- ✓ The upward revision in manufacturing growth in the new series also owes to inclusion of trade carried out by manufacturing companies in the manufacturing sector itself, which was earlier part of the services sector.
- ✓ the growth in manufacturing sector was chiefly on account of robust growth in textiles, apparels, and leather products
- ✓ The base revision has also shown that the contribution of the agriculture sector to overall GVA at factor cost is somewhat higher than was hitherto being shown on the basis of the earlier (2004-05) series
- ✓ The ratio of GVA to GVO shows that value addition is the highest in agriculture and lowest in manufacturing. The differences between the GVO shares and GVA shares are stark among all the sectors, particularly manufacturing.
- ✓ The low ratio of GVA to GVO in manufacturing signifies, on the one hand, that the sector creates substantial demand for the output of other sectors and, on the other, that Indian manufacturing needs to move up the value chain to improve its contribution to overall GVA.
- ✓ In manufacturing, GVO growth turned positive (4.3 per cent) in 2013-14, but it was outpaced by the growth in GVA. These emerging trends in manufacturing and services, indicating improving value addition and hence, in a way, greater efficiency in production, are encouraging.
- ✓ There was a downward pressure on aggregate demand due to the steep decline in the rate of capital formation (Table 1.6), constraining domestic absorption
- ✓ The decline in the rate of gross fixed capital formation (GFCF) during 2013-14 was much less pronounced than in the overall investment rate (gross capital

formation-GCF), because the other two components of GCF, viz. changes in stock and valuables, declined significantly

- ✓ valuables, i.e. the accumulation of gold, silver, and other precious metals, do not add much to the productive base either.
- ✓ Hence the decline in these items in 2013-14, though in accounting sense leads to a moderation in investment, need not be read much into. However, the almost five percentage point reduction in the rate of fixed investment (Table 1.7) from 2011-12 to 2014-15 would need to be reversed for growth to be sustained and augmented.
- ✓ The demand side of the GDP presented mixed signals in 2014-15. First, the increasing trends in consumption have gradually firmed up, with both private and government consumption growing in strength (Tables 1. 6 and 1.7). Second, the fixed capital formation in the economy has picked up growth but lost share in aggregate demand. Third, there is hardly any support to growth from exports.
- ✓ India operates at the lowest incremental capital output ratios (ICOR-based on GFCF) among the BRICS countries
- ✓ Given an average fixed investment rate of 30.5 per cent for 2012-13 and 2013-14, and given the average GDP growth of 6 per cent for these years, the ICOR works out to 5.1.
- ✓ saving rate (gross domestic savings as percentage of GDP)
- ✓ While the old series of savings is not strictly comparable with the new series (2011-12 base) for many reasons, including on account of the inclusion of 'valuables' as part of savings,
- ✓ Central Statistics Office (CSO) has recently revised the national accounts aggregates by shifting to the new base of 2011-12 from the earlier base of 2004-05 That this high growth occurred in a year when the both the savings and investment to GDP ratios were lower than the average of a number of years and when the level of imports (that are generally positively associated with GDP) actually declined by 8.4 per cent in real terms, is somewhat puzzling.
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- ✓ The low ratio of GVA to GVO in manufacturing signifies, on the one hand, that the sector creates substantial demand for the output of other sectors and, on the other, that Indian manufacturing needs to move up the value chain to improve its contribution to overall GVA. In manufacturing, GVO growth turned positive (4.3 per cent) in 2013-14, but it was outpaced by the growth in GVA. These emerging trends in manufacturing and services, indicating improving value addition and hence, in a way, greater efficiency in production, are encouraging. There was a downward pressure on aggregate demand due to the steep decline in the rate of capital formation (Table 1.6), constraining domestic absorption The decline in the rate of gross fixed capital formation (GFCF) during 2013-14 was much less pronounced than in the overall investment rate (gross capital formation-GCF), because the other two components of GCF, viz. changes in stock and valuables, declined significantly valuables, i.e. the accumulation of gold, silver, and other precious metals, do not add much to the productive base either. Hence the decline in these items in 2013-14, though in accounting sense leads to a moderation in investment, need not be read much into. However, the almost five percentage point reduction in the rate of fixed investment (Table 1.7) from 2011-12 to 2014-15 would need to be reversed for growth to be sustained and augmented. The demand side of the GDP presented mixed signals in 2014-15. First, the increasing trends in consumption have gradually firmed up, with both private and government consumption growing in strength (Tables 1. 6 and 1.7). Second, the fixed capital formation in the economy has picked up growth but lost share in aggregate demand. Third, there is hardly any support to growth from exports. India operates at the lowest incremental capital output ratios (ICOR-based on GFCF) among the BRICS countries Given an average fixed investment rate of 30.5 per cent for 2012-13 and 2013-14, and given the average GDP growth of 6 per cent for these years, the ICOR works out to 5.1. saving rate (gross domestic savings as percentage of GDP) While the old series of savings is not strictly comparable with the new series (2011-12 base) for many reasons, including on account of the inclusion of 'valuables' as part of savings, While the old series of savings is not strictly comparable with the new series (2011-12 base) for many reasons, including on account of the inclusion of 'valuables' as part of savings,
- ✓ The composition of capital formation is important in determining its productivity. This will be determined largely by the complementarities required between machinery and built-in structures. Table 1.10 conveys that

the addition to intellectual property products, which is separately shown as part of capital formation in the new series, is gradually picking up.

- ✓ It further shows that construction forms the major part of addition to fixed capital.

India's international trade:

- ✓ International Trade Over the last ten years, India's merchandise trade (on customs basis) increased manifold from US$ 195.1 billion in 2004-05 to US$ 764.6 billion in 2013-14 helping India's share in global exports and imports improve from 0.8 per cent and 1.0 per cent respectively in 2004 to 1.7 per cent and 2.5 per cent in 2013.

- ✓ ***Manufactured goods constituted the bulk of exports—over 63 per cent in recent years— followed by crude and petroleum products (including coal) with 20 per cent share and agriculture and allied products with 13.7 per cent share***. After crossing US $ 300 billion in 2011-12, there has been significant deceleration in growth rates of exports which is somewhat a global phenomenon as global trade volumes have not picked up significantly since the 2011 Eurozone crisis.
- ✓ ***Gems and jewellery exports which exhibited a declining trend in 2012-13 and 2013-14***, continued to decline in 2014-15 (April-January). Similarly, the decline in electronic goods exports since 2012-13 continued in 2014-15. Du
- ✓ There has been significant market diversification in India's trade in recent year
- ✓ Region-wise, India's export shares to Europe and America have declined over the year. Conversely, shares of India's exports to Asia and Africa have increased from 47.9 per cent and 6.7 per cent respectively in 2004-05 to 49.4 per cent and 9.9 per cent respectively in 2013-1

GHG emissions and climate change:

- ✓ The latest scientific findings (IPCC AR5) have estimated that to remain below 2°C, the world can emit only about 2900 giga-tonne (Gt) of CO_2 from all sources from the industrial revolution till 2100. Till 2011, the world has already emitted 1900 Gt of CO_2 and consumed around two-third of this budget. This means that out of the budget of 2900 Gt, only 1000 Gt remains to be used between now and 2100.

- ✓ There are substantial variations in total and per capita emissions of different countries. In terms of absolute CO_2 emissions in 2013, China, the USA, and EU hold the first three positions respectively with India a distant fourth. However, in terms of per capita CO_2 emissions in 2013, countries like India, Brazil, and South Africa fall in the bottom 100 among 196 countries.

Recoveries of loans and disinvestment are the two main constituents of non-debt capital receipts.

Non-Tax Revenue: Non-tax revenue mainly consists of interest and dividend receipts and the receipts from services provided by the central government.

Fiscal Reforms:

- ✓ The two pillars of fiscal reforms, as mentioned earlier, are ***revenue augmentation and expenditure rationalization.***
- ✓ The subsidy bill for BE 2014-15 was placed at ` 2.60 lakh crore / 2.0 per cent of GDP.
- ✓ The deregulation of diesel price in October 2014, along with the introduction of direct benefit (subsidy) transfer into the bank accounts of domestic LPG consumers, coupled with a sharp decline in global crude oil prices will help contain the petroleum subsidy bill.
- ✓ The rationalization of food subsidies is still an area where more effort is required.

Pradhan Mantri Jan-DhanYojana:

- ✓ The Yojana envisages universal access to banking facilities with at least one basic banking account for every household, financial literacy, access to credit and insurance. The beneficiaries will receive a RuPay Debit Card having inbuilt accident insurance cover of Rs1 lakh. In addition, there is a life insurance cover of `30,000 to those who opened their bank accounts for the first time between 15 August 2014 and 26 January 2015 and meet other eligibility conditions of the Yojana.

There are two broad categories of NBFCs based on whether they accept public deposits, viz., deposit-taking NBFCs (NBFC-D) and non-deposit-taking NBFCs (NBFC-ND).

Composition of Trade

- ✓ Manufactured goods constitute the bulk of exports — over 63 per cent in recent years, followed by crude and petroleum products
- ✓ agriculture and allied products with a share of 13.7 per cent share. The top seven product groups accounting for nearly 80.9 per cent of India's total exports in 2014-15 (April-December) were: petroleum products (19.4 per cent share); gems and jewellery (13.0 per cent share); agriculture and allied products (12.0 per cent share); textiles and allied products (11.6 per cent share); chemicals and related products (10.1 per cent share); transport equipment (8.5 per cent share) and machinery (6.3 per cent share).

- ✓ Growth in exports of petroleum and agriculture and allied products which had been in positive territory for the last four years, turned negative in 2014-15 (April-January). Gems and jewellery exports which exhibited a declining trend in 2012-13 and 2013-14, continued to register a declining trend in 2014-15 (April-January). In the case of electronic goods, there has been continuous decline in exports since 2012-13
- ✓ Marine products and leather and leather manufactures recorded relatively high growth

- ✓ imports of pearls and precious and semi-precious stones grew
- ✓ Gold and silver imports: Within Asia, India's exports to South Asia grew by 23.8 per cent (mainly due to high export growth to Sri Lanka, Nepal, and Bangladesh) and 8.8 per cent in the case of West Asia-Gulf Cooperation Council (GCC) (UAE, Saudi Arabia, and others). India's exports to other regions of Asia witnessed a contraction—declining by 4.4 per cent to North East Asia (consisting of China, Hong Kong, Japan), 7.2 per cent to the Association of South East Asian Nations (ASEAN) (consisting of Singapore, Indonesia, Thailand, Malaysia), and 8.5 per cent to Other West Asia (Iran, Israel, and others)—in 2014-15 (April-December). Country-wise, India's exports to the USA and UAE— major destinations with a share in India's

- ✓ The share of Europe in India's imports also declined while the shares of Asia and Africa increased substantially

- ✓ The share of America in India's imports has also increased from 8.8 per cent to 12.8 per cent during the same period. China is the major source of India's imports, accounting for 11.3 per cent of India's total imports, followed by Saudi Arabia (8.1 per cent share), the UAE (6.5 per cent share), and the USA (5.0 per cent share)

Some of the Trade Policy Measures Taken

- ✓ To promote domestic manufacturing capabilities, scrips issued under different schemes, namely FPS, FMS, VKGUY, MLFPS, Served From India Scheme (SFIS), Agri Infrastructure Incentive Scheme (AIIS), for import of goods can be utilized for payment of excise duty for domestic procurement. This is an important measure for import substitution and will help save foreign exchange as well as create additional employment.

- ✓ Similarly, scrips issued under the FPS, FMS, Vishesh Krishi and Gram UdyogYojana (VKGUY) schemes can be utilized for payment of service tax.
- ✓ To support export of products from the North Eastern Region (NER), exporters are entitled to additional incentives of 1 per cent of FOB value of exports in addition to other benefits under the FTP if exports are made from land customs station located in the NER.

- ✓ To diversify India's exports, 7 new markets (Algeria, Aruba, Austria, Cambodia, Myanmar, Netherlands Antilles, and Ukraine) have been added to the FMS, 7 new markets (Belize, Chile, EI Salvador, Guatemala, Honduras, Morocco, and Uruguay) to the Specia
- ✓ ***Indian trade portal (www.indiantradeportal.in) was launched on 8 December 2014. This portal provides vital information to Indian industry on forty-two export markets and also a mechanism to take advantage of the increased market access provided through various regional and bilateral free trade agreements (FTA) and comprehensive economic cooperation/partnership agreements (CECA/CEPA).***

Invisible account covers (a) services, (b) transfers, (c) income.

- ✓ Among the major economies with current account deficit, India is the second largest foreign exchange reserve holder after Brazil

Effective exchange rates are summary indicators of movement in the exchange rate of home currency against a basket of currencies of trade partner countries and are considered to be an indicator of international competitiveness. Real effective exchange rate (REER) indices are used

as indicator of external competitiveness of the country over a period of time.

India's debt:

The currency composition of India's total external debt shows that the share of US dollar-denominated debt in external debt stock continued to be the highest at 60.1 per cent at end-September 2014, followed by Indian rupee (24.2 per cent), special drawing rights (SDR) (6.5 per cent), Japanese yen (4.5 per cent), and euro (3.0 per cent) denominated.

Inflation:

- ✓ As fuel has larger weight in the WPI, the decline in fuel prices led to a sharper fall in the WPI as compared to the Consumer Price Index
- ✓ The decline in inflation during the year turned out to be much faster than was anticipated in the initial months of the year. Global factors, namely persistent decline in crude prices and softness in the global prices of tradables, particularly edible oils and even coal, helped moderate headline inflation. The tight monetary policy helped contain demand pressures, creating a buffer against any external shock and keeping volatility in the value of the rupee under check. During the last one year, the rupee remained relatively stable vis-à-vis the currency of peer emerging countries, which too had sobering influence on inflation. Moderation in wage rate growth reduced demand pressures on protein-based items. Base effect also contributed to the decline in headline inflation.

Agriculture:

- ✓ National Water Grid for transferring water from water surplus to water deficit areas have been made from time to time.
- ✓ Agricultural mechanization increases productivity of land and labour by meeting timeliness of farm operations and increases work output per unit time. Besides its paramount contribution to the multiple cropping and diversification of agriculture, mechanization also enables efficient utilization of inputs such as seeds, fertilizers, and irrigation water.
- ✓ ***Although India is one of the top countries in agricultural production, the current level of farm mechanization, which varies across states, averages around 40 per cent as against more than 90 per cent in developed countries. Farm mechanization in India has been growing at a rate of less than 5 per cent in the last two decades.***

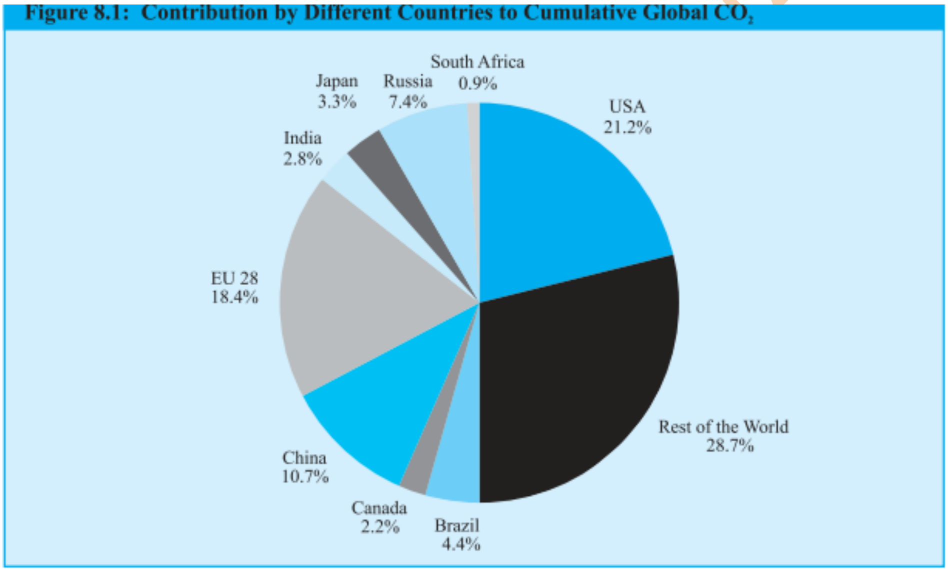
- ✓ The main challenges to farm mechanization are,

- first, a highly diverse agriculture with different soil and climatic zones, requiring customized farm machinery and equipment and,
- second, largely small landholdings with limited resources.
- Credit flow for farm mechanization is less than 3 per cent of the total credit flow to the agriculture sector. A dedicated Sub-Mission on Agricultural Mechanization has been initiated in the Twelfth Plan, with focus on spreading farm mechanization to small and marginal farmers and regions that have low farm power availability.

✓ The Pradhan Mantri Krishi Sinchayee Yojanawith allocation of` 1000 crore.

✓ ***Neeranchal,a new programme with an initial outlay of` 2142 crore in 2014 to give additional impetus to watershed development in the country,***

Figure 8.1: Contribution by Different Countries to Cumulative Global CO_2



Source **: Centre for Science and Environment and IPCC AR5.**

Recommendations of High Level Committee on restructuring FCI On procurement related issues:

✓ The FCI should hand over all procurement operations of wheat, paddy, and rice to states that have gained sufficient experience in this regard and have created reasonable infrastructure for procurement. The FCI will accept only the surplus (after deducting the needs of the states under the NFSA) from these state governments (not millers) to be moved to deficit states. The FCI should move on helping those states where farmers suffer from distress sales at prices much below MSP, and which are dominated by small holdings.

- ✓ Centre should make it clear to states that in case of any bonus being given by them on top of MSP, it will not accept grains under the central pool beyond the quantity needed by the state for its own PDS and OWS.
- ✓ The statutory levies including commissions need to be brought down uniformly to 3 per cent, or at most 4 per cent of MSP, and this should be included in the MSP itself (states losing revenue due to this rationalization of levies can be compensated through a diversification package for the next three-five years);

- ✓ The Government of India must provide better price support operations for pulses and oilseeds and dovetail their MSP policy with trade policy so that their landed costs are not below their MSP.
- ✓ Cash transfers in PDS should be gradually introduced, starting with large cities with more than 1 million population; extending it to grain surplus states; and then giving deficit states for the option of cash or physical grain distribution.
- ✓ On PDS- and NFSA-related issues:
  - Given that leakages in the PDS range from 40 to 50 per cent, the GoI should defer implementation of the NFSA in states that have not done end to end computerization; have not put the list of beneficiaries online for anyone to verify; and have not set up vigilance committees to check pilferage from PDS.
  - Coverage of population should be brought down to around 40 percent.
  - BPL families and some even above that they be given 7kg/person.
  - On central issue prices, while Antyodya households can be given grains at `3/2/1/kg for the time being, but pricing for priority households must be linked to MSP.

- ✓ On stocking and movement related issues:
  - FCI should outsource its stocking operations to various agencies.
  - Covered and plinth (CAP) storage should be gradually phased out with no grain stocks remaining in CAP for more than 3 months. · Silo bag technology and conventional storages wherever possible should replace CAP.

- ✓ On Buffer Stocking Operations and Liquidation Policy:
  - DFPD/FCI have to work in tandem to liquidate stocks in OMSS or in export markets, whenever stocks go beyond the buffer stock norms.
  - A transparent liquidation policy is the need of hour, which should automatically kick-in when FCI is faced with surplus stocks than buffer norms.
  - Greater flexibility to FCI with business orientation to operate in OMSS and export markets is needed.

- ✓ On direct subsidy to farmers:
  - Farmers be given direct cash subsidy (of about Rs 7000/ha) and fertilizer sector can then be deregulated.

- ✓ On end to end computerization:
  - The HLC recommends total end-to-end computerization of the entire food management system, starting from procurement from farmers, to stocking, movement, and finally distribution through the TPDS. On the new face of the FCI:
  - The new face of the FCI will be akin to an agency for innovations in the food management system with the primary focus of creating competition in every segment of the foodgrain supply chain, from procurement to stocking to movement and finally distribution under the TPDS, so that overall costs of the system are substantially reduced and leakages plugged and it serves a larger number of farmers and consumers

Recent initiatives to boost industrial growth

- ✓ Ease of Doing Business:To improve India`s low Ease of Doing Business Index ranking, reforms are being undertaken in areas such as starting a business, dealing with construction permits, registration of property, power supply, paying taxes, enforcing contracts, and resolving insolvency.
- ✓ ***Make in India: The Make in India programme is aimed to facilitate investment, foster innovation, enhance skill development, protect intellectual property, and build best-in-class manufacturing infrastructure***.

- ✓ E-Biz Project: Under the project a Government to Business (G2B) portal is being set up to serve as a one-stop shop for delivery of services to the investors and address the needs of the business and industry
- ✓ Skill development: After the setting up of a new Ministry of Skill Development and Entrepreneurship to promote skill and entrepreneurial activities, work is being undertaken on setting up common norms for skill training across central ministries/ departments. Thirty- one industry/employer-led Sector Skill Councils (SSCs) are now operational and these have been aligned with the twenty-five sectors of 'Make in India'. To create a common standard for skills training and certification in the country efforts are on to align the National Council for Vocational Training (NCVT), school boards, and the University Grants Commission (UGC).

- ✓ Streamlining environment and forest clearances:

- ✓ Labour- sector reforms

Eight core industries, viz. coal, fertilizer, electricity, crude oil, natural gas, refinery product, steel, and cement,

United Nations Industrial Development Organization's (UNIDO) Quarterly Report on World Manufacturing Production.

Recent Policy Initiatives for enhancing Crude Oil and Natural Gas production

- ✓ New Gas Pricing Formula: The Government approved the New Gas Pricing formula on 18 October, 2014 and released New Gas Pricing Guidelines, 2014. The increase in price of domestically produced natural gas strikes a fine balance between the expectations of investors and interests of consumers.
- ✓ Reforms in Production-Sharing Contracts to push Investment in Exploration: The government has ironed out a number of rigidities in production- sharing contracts to instil confidence among investors and ensure that work, which was stuck in a number of blocks, takes off in right earnest and without further delay.

- ✓ Reassessment of Hydrocarbon Potential: An elaborate plan has been rolled out to reassess hydrocarbon resources in India's sedimentary basins which will provide greater clarity to future investors on the prospects of the basins.
- ✓ Project for Survey of Un-appraised Sedimentary Basins of India: A project has been undertaken to appraise about 1.5 million sq. km area in twenty-four sedimentary basins where scanty geo-scientific data is available. Data generated under the project shall be stored, maintained, validated in a National Data Repository (NDR) which is being set up in the Directorate General of Hydrocarbons (DGH).

- ✓ Data Acquisition through Non Exclusive Multi-Client Model: A policy for acquisition of geo-scientific data through a non-exclusive multi-client model is being implemented. This model replaces the earlier fiscal term of profit sharing after cost recovery with the payment of a one- time project fee.
- ✓ Level Playing Field for Gas operations in the North East Region: For incentivizing exploration and production in the North East region, a 40 per cent subsidy on gas operations has been extended to private companies operating in the region.

- ✓ Gas Grid Infrastructure: In addition to the existing 15,000 km gas pipeline network, another 15,000 km has been planned for completion of the gas grid.

- ✓ Coal Bed Methane (CBM): Out of the total available coal-bearing area of 26,000 sq. km for CBM exploration in the country, exploration has been initiated in about 17,000 sq. km. The estimated CBM resources in the country are about 92 trillion cubic feet (TFC), of which only 9.9 TCF has so far been established. Commercial Production of CBM in India has now become a reality with current production of about 0.60 million metric standard cubic metre per day (MMSCMD)

The salient features of the Mines & Minerals (Development Regulations) (Amendment Ordinance 2015) include: –

- ✓ Auction for realization of fair value
- ✓ (b) Dispensing with discretion and addressing possible disruption: To remove discretion in grant of renewals, provisions for renewal of mining leases has been removed.
- ✓ After fifty years a lease will be auctioned afresh.
- ✓ (c) Relief to project-affected people/district:
- ✓ d) Boost to exploration: The establishment of a National Mineral Exploration Trust has been proposed for the purpose of regional and detailed exploration.
- ✓ (e) Easy transferability to encourage private sector participation: To attract private agencies and promote the latest technology, a provision has been made for easy transfer of mineral concessions
- ✓ (f) Timely disposal of cases: For eliminating delays in administration and facilitating expeditious and optimum development of the mineral resources, a provision has been made to empower the central government to frame rules for fixing time limits
- ✓ (g) Deterrents against illegal mining: To curb the menace of illegal mining, imposition of stricter penalties like imprisonment up to five years or fine up to ` 5 lakh per hectare of area

Meghalaya gets rail connectivity: Meghalaya got its first rail connectivity with the completion of the new Dubhnoi-Mendipathar line in August 2014. A new route from Mendipathar in Meghalaya to Guwahati in Assam, got connected by rail in November , 2014.

The US ranks first in services GDP as well as in overall GDP, with China and Japan a distant second and third. Among the world's top 15 countries in terms of GDP, India ranked 10 th in terms of overall GDP and 11 th in terms of services GDP in 2013.

International Labour Organization's (ILO) Global Employment Trends

- ✓ India's major services exports in 2013-14 are computer services (45.8 per cent share); other business services (18.8 per cent share) including professional and consulting services (10.2 per cent share), technical and trade-related services (7.8 per cent share) and R & D services (0.8 per
- ✓ travel (11.8 per cent share); transport (11.5 per cent share); and financial, insurance and pension services (5.8 per cent share).
- ✓ Joint Announcement on Climate Change by the United States and China— the world's two largest emitters—in November 2014. As per this announcement, the US intends to achieve an economy-wide target of reducing its emissions by 26 -28 per cent below its 2005 level in 2025 and to make best efforts to reduce its emissions by 28 per cent. China intends to achieve the peaking of carbon dioxide (CO_2)
- ✓ emissions around 2030 and to make best efforts to peak early and intends to increase the share of non-fossil fuels in primary energy consumption to around 20 per cent by 2030. This has great
- ✓ increasing trend in the anthropogenic emissions of greenhouse gases (GHG) since the advent of the industrial revolution, with about half of the anthropogenic CO_2 emissions during this period occurring in the last forty years.The period 1983-2012 is likely to have been the warmest thirty-year period of the last 1400 years. CO_2 emissions from fossil fuel combustion and industrial processes have contributed a major portion of total GHG emissions during the period 1970 - 2010.
- ✓ The ecological overshoot problem, i.e. the ecological footprint being larger than the bio-capacity of the population, is an important issue in the global climate discourse. The 'overshoot'can also be understood in terms of the carbon budget.
- ✓ Since 2000 GHG emissions have been growing in all sectors, except agriculture, forestry, and other land use (AFOLU).
- ✓ . Of the 49 (±4.5) $GtCO_2eq$ (CO_2 equivalent) emissions in 2010
- ✓ 35 per cent were released in the energy supply sector, 24 per cent in AFOLU, 21 per cent in industry, 14 per cent in transport, and 6.4 per cent in buildings (Figure 8.2).
- ✓ There are substantial variations in total and per capita emissions of different countries. As per AR5 of IPCC, per capita GHG emissions in 2010 were highly unequal with median per capita emissions for the group of low-income countries (1.4 t CO_2 eq/cap) being 9 times lower than median per capita emissions of high income countries (13 t CO_2eq/cap). In terms of absolute CO_2 emissions from fossil fuel use and cement production in 2013, China, the USA, and EU hold the first three positions respectively with India a distant 4 th (Figure 8.3). However, in terms of per capita CO_2 emissions from the same sectors in 2013, countries like India, Brazil, and South Africa fall in the bottom 100 among 196 countries

India's total renewable power installed capacity as on 31 December 2014 has reached 33.8 GW. Wind energy continues to dominate this share accounting for 66 per cent of installed capacity, followed by biomass, small hydro power, and solar power.

The National Bank for Agriculture and Rural Development (NABARD) is India's National Implementing Entity (NIE) for the Adaptation Fund created under the UNFCCC

The Global Environment Facility (GEF) is one of the two operating entities under the financial mechanism as per Article 11. It funds projects in energy efficiency, renewable energy, sustainable urban transport, and sustainable management of land use, land-use change and forestry and climate-smart agriculture.

Key Lima Outcomes

- ✓ The UNFCCC negotiations focused on the finalization of elements of the draft negotiating text for the 2015 Paris agreement, identification of information to be submitted by Parties under the Intended Nationally Determined Contributions (INDCs), and enhancement of pre 2020 actions. Some of the important outcomes of the Lima Conference are the following: • ***The Lima Conference has decided that the new agreement will be under the UNFCCC and will reflect the principle of CBDR in the light of different national circumstances. It also addresses all elements, i.e. mitigation, adaptation, finance, technology development and transfer, capacity building, and transparency of action and support in a balanced manner.***

- ✓ Another key decision was that countries should not backslide from current pledges under the INDCs and their contribution has to be more than their current commitments.
- ✓ On the Green Climate Fund (GCF), pledges amounting to US$ 10.2 billion for initial capitalization of the Fund have been acknowledged.

- ✓ The GEF also manages two separate adaptation-focused funds under the UNFCCC— the Least Developed Countries Fund and the Special Climate Change Fund— which mobilize funding specifically earmarked for activities related to adaptation. The GCF is also an operating entity of the financial mechanism of the Convention set up in 2011. The GCF is expected to become the major channel of mobilizing a significant share of the US$ 100 billion climate finance from developed

- ✓ Significant progress has been made towards operationalizing the GCF. Some of the breakthrough decisions adopted include: ***50:50 allocation for mitigation and adaptation over time; maximizing engagement with the private sector through a special Private Sector Facility of the Fund***; and the intention of defining the Fund's gender action plan soon. As of date, ***US$ 10.2 billion in grants has been pledged to the GCF.***

- ✓ Ministry of Environment, Forests and Climate Change as India's Nationally Designated Authority (NDA) for the GCF which will recommend to the Board of the GCF funding proposals in the context of national climate strategies.
- ✓ "The Future We Want"—of the UN Conference on Sustainable Development (Rio+20) held in June 2012 at Rio came out with a set of 17 SDGs in July 2014

Demographic dividend:

- ✓ Population projections indicate that in 2020 the average age of India's population will be the lowest in the world—around 29 years compared to 37 years in China and the United States of America, 45 years in West Europe, and 48 years in Japan. Consequently, while the global economy is expected to witness a shortage of
- ✓ According to an Indian Labour Report (Time Lease, 2007), 300 million youth will enter the labour force by 2025, and 25 per cent of the world's workers in the next three years will be Indians.

- ✓ young population of around 56 million by 2020, India will be the only country with a youth surplus of 47 million
- ✓ The main issue to address then is not just providing employment but increasing the employability of the labour force in India. Employability is contingent upon knowledge and skills developed through quality education and training.

- ✓ ASER (Annual Status of Education Report) findings have been reporting low levels of learning amongst the 5 to 16 age group in rural India
- ✓ It is noteworthy that India's total fertility rate (TFR) has been steadily declining and is now at 2.3; while state-wise disparities exist, a declining trend is recorded across states, explaining the declining growth rate of population. India is set to reach the UN Millennium Development Goals (MDG) with respect to maternal and child survival. The MDG for maternal mortality ratio (MMR) is 140 per 100,000 live births, while India had achieved 178 by 2010-12 and is estimated to reach 141 by 2015. The under-5 mortality rate (U5MR) MDG is 42, while India has an U5MR of 52 and is expected to reach 42 by

2015. This is particularly creditable as in 1990 India's MMR and U5MR were 47 per cent and 40 per cent above the international average respectively.

Mission Indradhanush was launched on 25 December 2014 with the aim of covering all those children who are either unvaccinated or are partially vaccinated against seven vaccine-preventable diseases which include diphtheria, whooping cough, tetanus, polio, tuberculosis, measles, and hepatitis B by 2020.

The Gender Development Index (GDI), defined as a ratio of the female to male HDI measures gender inequality according to three basic parameters of human development: health (LEB), education (expected years of schooling for children and mean years for adults aged 25 years and older); and command over economic resources (estimated GNI per capita).

- ✓ Country rankings are based on absolute deviation from gender parity in HDI. The GDI is calculated for 148 countries. ***The female HDI value for India is 0.52 as compared to 0.63 for males, r***esulting in a GDI value of 0.828. ***In comparison, Bangladesh and China are ranked higher*** with values of 0.908 and 0.939 respectively. Thus, while India is in the bottom 25 per cent of all countries on the HDI, it ranks in the bottom 20 per cent on the GII.

Social sector measures:

- ✓ To facilitate coordinated functioning of various social infrastructure and human development programmes, the government has launched the Sansad Adarsh Gram Yojna (SAGY)
- ✓ In addition, the Vanbandhu Kalyan Yojna will be implemented in one block each of ten states that have Fifth Schedule areas.

- ✓ A declining 0-14 population will impact both elementary (5-14 age group) and higher education (15-29 age group). Elementary education can be further subdivided into primary (5-9 age group) and middle/upper primary (10-14 age group). The first stage of impact will be felt in declining enrolment in primary schools.
- ✓ improving access to education considering the high dropout rates among senior students; (ii) removing gender disparity especially in the higher age group and in rural areas; and (iii) improving quality of education, including pupil-teacher ratios and provision of amenities in schools, especially in view of the declining learning levels.

- ✓ For instance, the projected average age of 29 years in 2020 has already been surpassed in some states like Kerala (33 years), Goa (32.3), Tamil Nadu (31.3), Himachal Pradesh (30.4), Punjab (29.9), Andhra Pradesh (29.3), and West Bengal (29.1). This lag in demographic transition among states in India could turn out to be a great blessing from the point of view of coping with the problem of declining population. India is better placed in this respect than most other countries. Thus states already well into the demographic window should actively pursue policies for employment generation to the already bulging labour force, while states just entering the window period have some time to plan and must pursue policies simultaneously in several areas like education, health (including reproductive health), gender issues, and employment generation from now on so that they can fully utilize the opportunity.