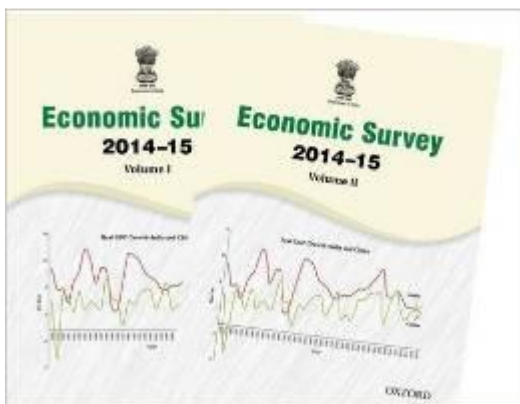
Unit 12. Economic Survey 2014-15 Summary

Economic Survey, the annual flagship document of the Department of Economic Affairs, Ministry of Finance is the best material to study the state of Indian Economy.

Economic Survey 2014-15: Changes



Flow of most surveys were something similar to what is given below and were published as single-volume-documents containing 13 or 14 chapters.

- Analysis of last financial year
- Objectives for next financial year
- Challenges and concerns
- Solutions that can be taken
- Forecasts the economic situation of next year

Inspired by the IMF's World Economic Outlook, 2014-15 Survey departs structurally from its predecessors and presents its output in two volumes. Volume 1, the forward looking document analyses the prospects of the economy while Volume 2, the backward looking doucment analyses the state of Indian economy. From the UPSC exam perspective, we feel Volume 2 is more important for Prelims. Volume 1 can provide invaluable analyse and points for Mains.

Volume 1: Outlook, Prospects and Concerns – Forward Looking

1. Economic Outlook, Prospects and Policy Challenges
2. Fiscal Framework
3. 'Wiping Every Tear From Every Eye' : The JAM Number Trinity Solution
4. The Investment Climate: Stalled Projects, Debt Overhang and The Equity Puzzle
5. Credit, Structure and Double Financial Repression: A Diagnosis of the Banking Sector
6. Putting Public Investment on Track: The Rail Route to Higher Growth
7. What to Make in India? Manufacturing or Services?
8. A National Market for Agricultural Commodities- Some Issues and Way Forward
9. From Carbon Subsidy to Carbon Tax : India's Green Actions
10. The Fourteenth Finance Commission (FFC) – Implications for Fiscal Federalism in India?

Volume 2: Recent Developments – Backward Looking

1. State of the Economy – an overview
2. Public Finance
3. Monetary management and financial intermediation
4. External Sector
5. Price, Agriculture and Food Management
6. Industrial, Corporate and Infrastructure Performance
7. Services Sector
8. Climate Change and Sustainable Development
9. Social Infrastructure, Employment and Human Development

Key Points from Economic Survey

- The broad themes of the Survey are "creating opportunity and reducing vulnerability."
- A Growth Rate of over 8 Per Cent Expected for the Coming Year.
- A Double-Digit Economic Growth Trajectory is now a Possibility.
- Such a Growth Could Help in 'Wiping Every Tear From Every Eye' and Realizing Aspiration of India's Youth.

- There is Political Mandate for Reform and Benign External Environment now, says the Economic Survey.
- There is Scope for Big Bang Reforms now.
- Economic Survey highlights the need for balance between 'Make in India' and 'Skilling India.'
- Major Reform Initiatives Undertaken by Government in Banking, Insurance and Financial Sector.
- Wiping Every Tear from Every Eye: The Jan Dhan Yojana, Aadhaar and Mobile Numbers Provide the Solution.
- Improvement in Female Literacy and Educational Challenges.
- Skill Development and Employment are major Challenges.
- Economic Survey Recommends Reform of Railway's Structure, Commercial Practices, Overhaul of Technology.
- India needs to create additional Fiscal Space.
- India's National Solar Mission Being Scaled up Five-Fold to 100,000 Megawatts.
- Infrastructure Growth in terms of Eight Core Industries Higher than Industrial Growth since 2011-12.
- Government Remains Committed to Fiscal Consolidation; Economic Survey says Enhanced Revenue Generation is a Priority.
- External Sector is returning to the path of strength and resilience.
- Services Sector Clocks Double Digit Growth.
- Hyper-Growth in Tech start ups in India, says Economic Survey on Services Sector.
- The Fourteenth Finance Commission (FFC) will enhance Fiscal Federalism in India.
- Government approves a Rs. 200 crore Central Sector Scheme for implementing e-platform for agri-marketing.
- Revive public investment to improve investment climate: Economic Survey 2014 – 15.
- Create National Common Market in Agricultural Commodities: Economic Survey 2014-15.
- India's Green Actions: From Carbon Subsidy to Carbon Tax.
- Food Subsidy Bill stands at Rs. 107823.75 crore during 2014-15 (upto January, 2015), shows an increase of 20% over previous year.
- Foodgrains production for 2014-15 estimated at 257.07 million tonnes; will exceed average food grain production of last five years by 8.5 million tones.
- Inflation shows a declining trend during the year 2014-15 (April-December).

Economic Survey 2014-15 Highlights

The highlights from selected chapters:

Economic Outlook, Prospects and Policy Challenges

- Macroeconomic fundamentals in 2014-15 have dramatically improved. Highlights are:

1. Inflation has declined by over 6 percentage points since late 2013.

2. The current account deficit has declined from a peak of 6.7 percent of GDP (in Q3, 2012-13) to an estimated 1.0 percent in the coming fiscal year.
3. Foreign portfolio flows have stabilized the rupee, exerting downward pressure on long-term interest rates, reflected in yields on 10-year government securities, and contributed to the surge in equity prices.
4. In response to the favourable terms of trade shock (especially with regard to oil), macroeconomic policy has appropriately balanced government savings (two-thirds) and private consumption (one-third).
5. After a nearly 12-quarter phase of deceleration, real GDP has been growing at 7.2 percent on average since 2013-14, based on the new growth estimates of the Central Statistics Office. Notwithstanding the new estimates, the balance of evidence suggests that India is a recovering, but not yet a surging, economy.

- From a cross-country perspective, a Rational Investor Ratings Index (RIRI) which combines indicators of macro-stability with growth, illustrates that India ranks amongst the most attractive investment destinations. It ranks well above the mean for its investment grade category (BBB), and also above the mean for the investment category above it (on the basis of the new growth estimates).
- Several reforms have been undertaken and more are on the anvil. The introduction of the GST and expanding direct benefit transfers can be game-changers.
- Structural shifts in the inflationary process are underway due to lower oil prices, deceleration in agriculture prices and wages, and dramatically improved household inflation expectations. Going forward inflation is likely to remain in the 5-5.5 percent range, creating space for easing of monetary conditions.
- In the short run, growth will receive a boost from the cumulative impact of reforms, lower oil prices, likely monetary policy easing facilitated by lower inflation and improved inflationary expectations, and forecasts of a normal monsoon in 2015-16.Using the new estimate for 2014-15 as the base, GDP growth at constant market prices is expected to accelerate to between 8.1 and 8.5 percent in 2015-16.
- Medium-term prospects will be conditioned by the “balance sheet syndrome with Indian characteristics” that has the potential to hold back rapid increases in private sector investment. Private investment must be the engine of long-run growth. However,there is a case for reviving targeted public investment as an engine of growth in the short run to complement and crowd-in private investment.
- India can balance the short-term imperative of boosting public investment to revitalize growth with the need to maintain fiscal discipline. Expenditure control, and expenditure switchingfrom consumption to investment,will be key.
- The outlook is favourable for the current account deficit and its financing. A likely surfeit, rather than scarcity, of foreign capital will complicate exchange rate management. Reconciling the benefits of these flows with their impact on exports and the current account remains an important challenge going forward.
- India faces an export challenge, reflected in the fact that the share of manufacturing and services exports in GDP has stagnated in the last five years. The external trading environment is less benign in two ways: partner country growth and their absorption of Indian exports has slowed, and mega-regional trade agreements being negotiated by the major trading nations in Asia and Europe threaten to exclude India and place its exports at a competitive disadvantage.

- India is increasingly young, middle-class, and aspirational but remains stubbornly male. Several indicators suggest that gender inequality is persistent and high. In the short run, the renewed emphasis on family planning targets,backed by misaligned incentives, is undermining the health and reproductive autonomy of women.

Fiscal Framework

- India must adhere to the medium-term fiscal deficit target of 3 percent of GDP. This will provide the fiscal space to insure against future shocks and also to move closer to the fiscal performance of its emerging market peers.
- India must also reverse the trajectory of recent years and move toward the golden ruleof eliminating revenue deficits and ensuring that, over the cycle, borrowing is only for capital formation.
- Expenditure control combined with recovering growth and the introduction of the GST will ensure that medium term targets are comfortably met.
- In the short run, the need for accelerated fiscal consolidation is lessened by the dramatically changed macro-circumstances and the less-than-optimal nature of pro-cyclical policy. The ability to do so will be conditioned by the recommendations of the Fourteenth Finance Commission (FFC).
- Nevertheless, to ensure fiscal credibility and consistency with medium-term goals, the process of expenditure control to reduce the fiscal deficit should be initiated. At the same time, the quality of expenditure needs to be shifted from consumption, by reducing subsidies, towardsinvestment.
- Finally, implementing the FFC recommendations will lead to states accounting for a large share of total tax revenue. This has the important implication that, going forward, India's public finances must be viewed at the consolidated level and not just at the level of the central government. If recent trends in state-level fiscal management continue, the fiscal position at the consolidated level will be on a sustainable path.

Subsidies and the JAM Number Trinity Solution

- The debate is not about whether but how best to provide support to the poor and vulnerable. The government subsidises a wide variety of goods and services with the aim of making them affordable for the poor, including: rice, wheat, pulses, sugar, railways, kerosene, LPG, naphtha, iron ore, fertiliser, electricity, water.
- The direct fiscal cost of these select subsidies is roughly Rs. 378,000 crore or 4.2 percent of 2011-12 GDP. This is roughly how much it would cost to raise the expenditure of every household to the level of a 35th percentile household (well above the 21.9percentTendulkar Committee poverty line).
- Are these subsidies effectively targeted at the poor? Unfortunately, subsidies can sometimes be regressive and suffer from leakages. For example, electricity subsidies by definition only help electrified households. Even in the case of kerosene, 41 percent of PDS kerosene is lost as leakage and only 46 percent of the remaining 59 percent is consumed by households that are poor.
- The JAM Number Trinity – ***J***an Dhan Yojana, ***A***adhaar, ***M***obile – can enable the State to transfer financial resources to the poor in a progressive manner without leakages and with minimal distorting effects.

The Investment Challenge

- The stock of stalled projects stands at about 7 percent of GDP, accounted for mostly by the private sector. Manufacturing and infrastructure account for most of the stalled projects. Changed market conditions and impeded regulatory clearances are the prominent reasons for stalling in private and public sectors, respectively.
- This has weakened the balance sheets of the corporate sector and public sector banks, which in turn is constraining future private investment, completing a vicious circle.
- Despite high rates of stalling, and weak balance sheets, the stock market valuations of companies with stalled projects are quite robust,which is a puzzle.
- Combining the situation of Indian public sector banks and corporate balance sheets suggests that the expectation that the private sector will drive investment needs to be moderated. In this light, public investment may need to step in to ramp up capital formation and recreate an environment to crowd–inthe private sector.

The Banking Challenge

- The Indian banking balance sheet is suffering from 'double financial repression'. On the liabilities side, high inflation lowered real rates of return on deposits. On the assets side, statutory liquidity ratio (SLR) and priority sector lending (PSL) requirements have depressed returns to bank assets. As inflation moderates and the banking sector exits liability-side repression, it is a good time to consider addressing the asset-side counterpart.
- In a cross-country comparison, controlling for the level of development, the size of the Indian banking system, measured by credit indicators, does not seem too high either in absolute terms or relative to other sources of financing. However, going forward, capital markets and bond-financing need to be given a boost.
- Private sector banks did not partake in the biggest private-sector-fuelled growth episode in Indian historyduring 2005-2012. This is reflected in the near-constant share of private sector banks in deposits and advances in those years.
- There is substantial variation in the performance of the public sector banks, so that they should not be perceived as a homogenous block while formulating policy.

Putting Public Investment on Track – the Rail Route to Higher Growth

- The Indian Railways over the years have beenon a 'route to nowhere'characterized byunderinvestment resulting in lack of capacity addition and network congestion; neglect of commercial objectives; poor service provision; and consequent financial weakness. These have cumulated to below-potential contribution to economic growth.
- Very modest hikes in passenger tariffs and cross-subsidisation of passenger services from freight operations over the years have meant that Indian (PPP-adjusted) freight rates remain among the highest in the world, with the railways ceding significant share in freight traffic to roads (that is typically more costly and energy inefficient).

- As a result, the competitivenessof Indian industry has been undermined. Calculations reveal that 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.
- Econometric evidence suggests that the railways public investment multiplier (the effect of a Rs. 1 increase in public investment in the railwayson overall output) is around 5.
- However, in the long run, the railways must be commercially viable and public support must be linked to railwayreforms: adoption of commercial practices; tariff rationalization; and technology overhaul.

Skill India to Complement Make in India

- What should we 'Make in India'? Sectors that are capable of facilitating structural transformation in an emerging economy must:
  - Have a high level of productivity.
  - Show convergence to the technological frontier over time.
  - Draw in resources from the rest of the economy to spread the fruits of growth.
  - Bealigned with the economy's comparative advantage; and
  - Betradeable.
- Registered manufacturing, construction and several service sectors — particularly business services — perform well on these various characteristics. A key concern with these sectors however is that they are rather skill-intensive and do not match the skill profile of the Indian labour force.
- India could bolster the Make in India"initiative, which requires improving infrastructure and reforming labor and land laws by complementing it with the"Skilling India initiative. This would enable a larger section of the population to benefit from the structural transformation that such sectors will facilitate.

A National Market for Agricultural Commodities

- Markets in agricultural products are regulated under the Agricultural Produce Market Committee (APMC) Act enacted by State Governments. 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.
- The Model APMC Act, 2003 could benefit from drawing upon the 'Karnataka Model' that has successfully introduced an integrated single licensing system. The key here is to remove the barriers that militate against the creation of choice for farmers and against the creation of marketing infrastructure by the private sector.

Climate Change

- India has cut subsidies and increased taxes on fossil fuels (petrol and diesel along with a coal cess) turning a carbon subsidy regime into one of carbon taxation. The implicit carbon tax is US$ 140 for petrol and US$64 for diesel.
- In light of the recent falling global coal prices and the large health costs associated with coal, there may be room for further rationalization of coal pricing. The impact of any such changes on affordable energy for the poor must be taken into account.

- On the whole, the move to substantial carbon taxation combined with India's ambitious solar power program suggests that India can make substantial contributions to the forthcoming Paris negotiations on climate change.

The Fourteenth Finance Commission

- The FFC marks a watershed in the history of Indian federalism. Unprecedented increases in tax devolution will confer more fiscal autonomy on the states. This will be enhanced by the FFC-induced imperative of having to reduce the scale of other central transfers to the states. In other words, states will now have greater autonomy both on the revenue and expenditure fronts.
- All states stand to gain from extra resources although there will be some variation between the states.
- FFC transfers are highly progressive; that is, states with lower per capita NSDP receive on average much larger transfers per capita. In contrast, plan transfers were much less progressive.
- The concern that more transfers will undermine fiscal discipline is not warranted because states as a whole have been more prudent than the centre in recent years

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