

Economic Survey 2016-17

Agenda

- 1 Economic Outlook and Policy Challenges
- 3 Demonetization: To Deify or Demonize?
- 4 The Festering Twin Balance Sheet Problem
- 5 Fiscal Framework: World is Changing, Should India change too?
- 11 One Economic India: For the Goods and in the Eyes of the Constitution

Chapter 1: Economic Outlook and policy Challenges

- Targets?
- Achievements?
- Important events of the year?



Other Important decisions taken:

- Bankruptcy law
- MPC
- Legal status to Aadhar

Chapter 1: Economic Outlook and policy Challenges

General Macro indices:

1. GDP
2. Inflation
3. External Balances
4. Fiscal



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Chapter 1: Economic Outlook and policy Challenges

Other issues:

1. Climate change – Ratification of INDCs, Carbon tax



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Chapter 1: Economic Outlook and policy Challenges

Other issues:

2. Ensuring Women's Privacy: Gender based sanitation insecurity
 - threat to life and safety while going out for open defecation
 - reduction in food and water intake practices to minimize the need to exit the home to use toilets
 - polluted water leading to women and children dying from childbirth-related infections

Leadership role in Swachh Bharat

Chapter 1: Economic Outlook and policy Challenges

Other issues:

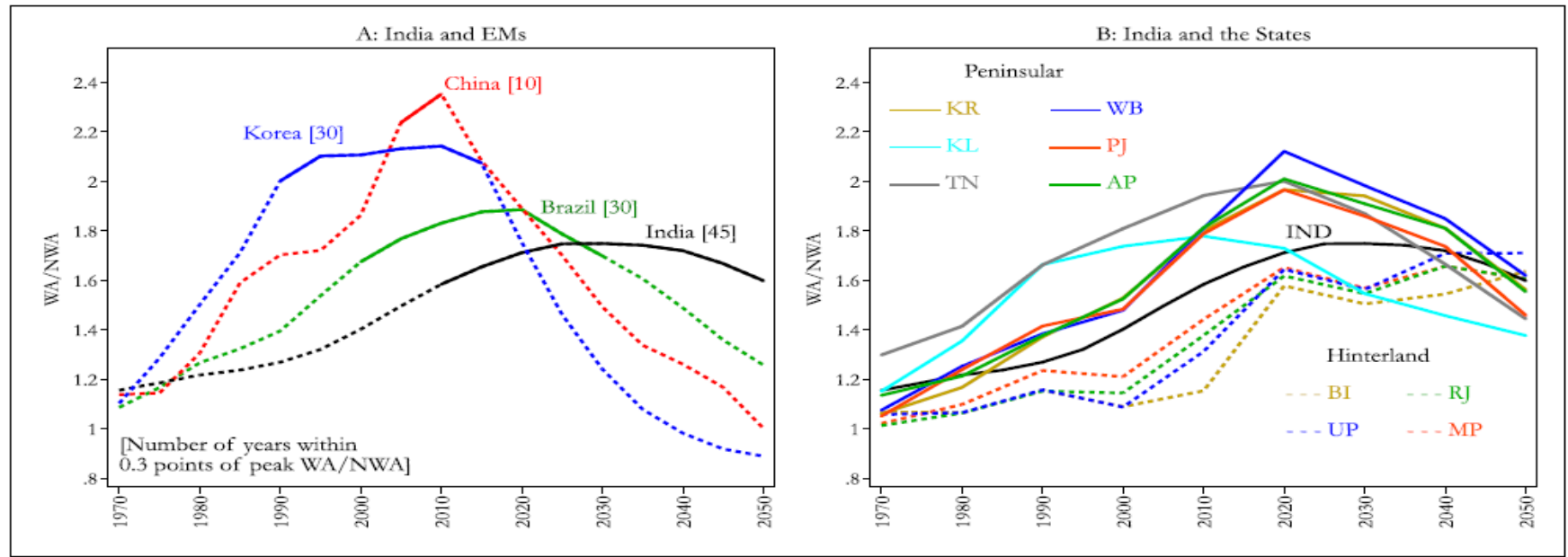
3. India's Demographic Dividend: Potential not destiny

- Over the next three decades, the United Nations (UN) projects that China and Russia will each see their WA populations fall by over 20 per cent
- India's working-age population is projected to grow by a third over the same period
- Potential:
 - younger populations are more entrepreneurial thus adding to productivity growth
 - tend to save more, which may also lead to favourable competitiveness effects
 - and have a larger fiscal base because of economic growth and because there are fewer dependents (children and elderly) for the economy and government to support

Chapter 1: Economic Outlook and policy Challenges

Other issues:

3. India's Demographic Dividend: Distinctive Demography



Chapter 1: Economic Outlook and policy Challenges

India and the Rating agencies : Poor Standards

Factors warranting revision:

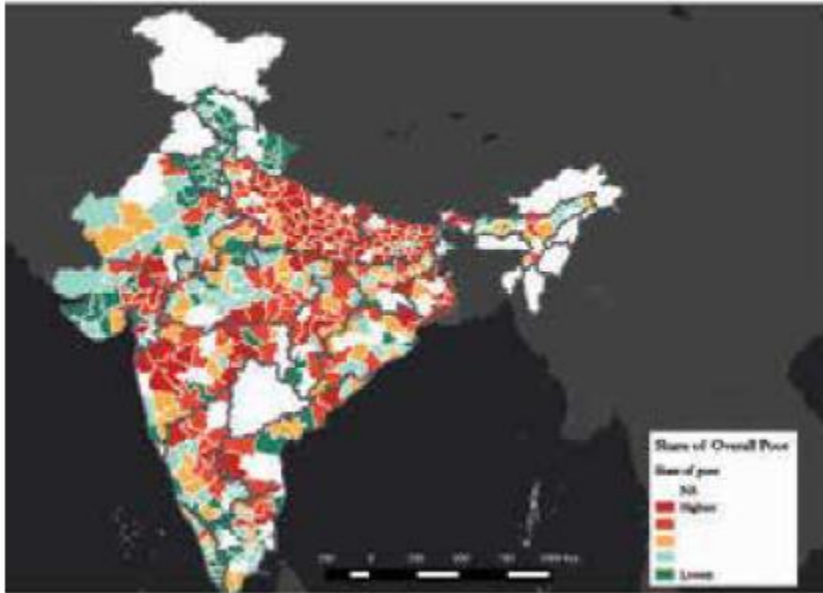
- Reforms undertaken
- Commitment to Fiscal Discipline
- High GDP growth rates
- Stable external balances
- Declining inflation
- Exceptionally high willingness to pay

Instead, the standards used:

- Per capita GDP
- Fiscal deficit

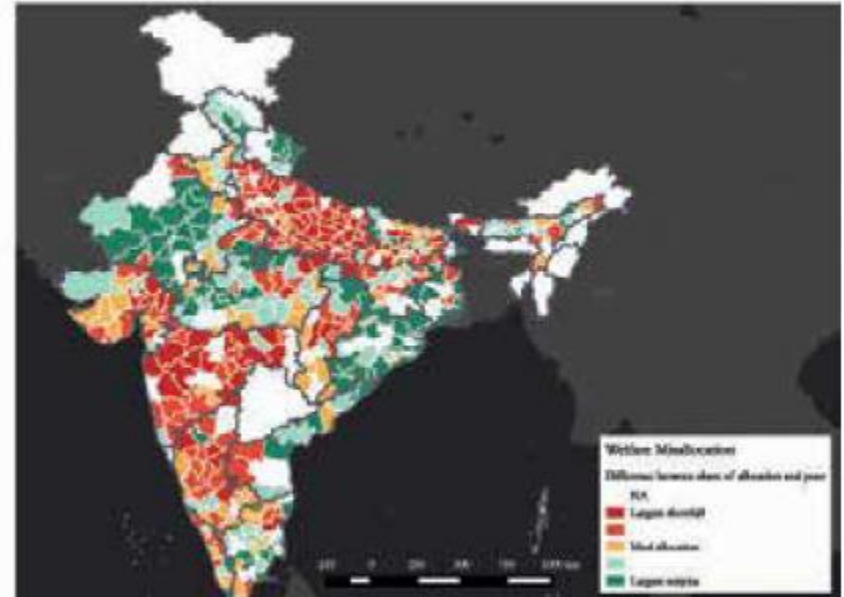
Chapter 1: Economic Outlook and policy Challenges

Figure 18a. Share of Overall Poor



Source: NSS 2011-12.

Figure 18b. Shortfall in Allocation to Poor



Source: GOI and NSS 2011-12.

Ques: While competitive federalism has been a powerful agent of change in relation to attracting investment and talent, it has been less in evidence in relation to essential service delivery. Comment.

Chapter 1: Economic Outlook and policy Challenges

Challenges ahead for Growth (and possible ratings upgrade)

- Weak private investment and festering twin-balance sheet problem
- Reduce inefficient redistribution
- Strengthen state capacity in delivering essential services and in regulating markets
- Dispelling the ambivalence about protecting property rights and embracing the private sector
- Internationally, there are signs of protectionism (Brexit, Trump)
- Rise in oil prices

Chapter 3: Demonetisation: To Deify or Demonise?



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Chapter 3: Demonetisation: To Deify or Demonise?

- The new unconventional monetary policy? – Helicopter Hoover

Objectives of Demonetisation:

- To curb corruption;
- Counterfeiting;
- The use of high denomination notes for terrorist activities; and
- Accumulation of “black money”

Impact of Demonetisation:

1. Economic

1. Impact on supply of cash, money and interest rates: New Equilibrium?
Significance of Cash-GDP ration
Estimation of black money? Soiling rates.



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Chapter 3: Demonetisation: To Deify or Demonise?

Impact of Demonetisation (Continued):

1. Economic

1. On GDP?

Markers for estimation:

- Agricultural (rabi) sowing;
- Indirect tax revenue, as a broad gauge of production and sales;
- Auto sales, as a measure of discretionary consumer spending and two-wheelers, as the best indicator of both rural and less affluent demand;
- Real credit growth; and
- Real estate prices

Understanding the new GDP numbers

GDP v/s GVA

Estimates by CSO

Cautions

Chapter 3: Demonetisation: To Deify or Demonise?

Impact of Demonetisation (Continued):

Potential long term benefits:

- Tax on black money: Declare, Hide, Launder
- Tax compliance: Cost of evasion: Legal, Social
- Savings-Investment rates
- Digitalisation



Cash v/s Digital?

Benefits of Cash:

- It is convenient,
- Accepted everywhere, and
- Its use is costless
- Cash transactions are also anonymous, helping to preserve privacy

Challenges in going Digital:

- Cell Phones
- POS
- Internet infra
- Costly
- Government policy till date
- Inter-operability

Chapter 3: Demonetisation: To Deify or Demonise?

Impact of Demonetisation (Continued):

- Aggregate Demand Shock
- Aggregate Supply Shock: Substitution with Digital?
- An uncertainty shock
- Estimation using Quantity theory of money



Chapter 3: Demonetisation: To Deify or Demonise?

Impact of Demonetisation (Continued):

$$MV = PY$$

- M refers to the money supply
- V is velocity, the rate at which money turns over
- P, the price level
- Y, real GDP
- M = Due to impeded convertibility, cash and bank deposits need to be considered separately.
- P = demonetisation is predominantly an aggregate demand shock, we should expect some reduction in prices as well.
- V = cash the binding constraint

Impact of Demonetisation (Continued):

Costs associated:

- Inconvenience and hardships
- Costs of printing new notes over and above normal replacement.
- Sterilizing the surge in liquidity
- Decline in nominal GDP growth

Chapter 3: Demonetisation: To Deify or Demonise?

Minimising the costs:

- Fast remonetisation
- Inter-convertibility of payments
- Incentivise tax compliance
- Bringing land and real estate under GST
- Reducing taxes and stamp duties
- A cooperative (and not over-zealous) tax administration

Chapter 4: The Festering Twin Balance Sheet Problem

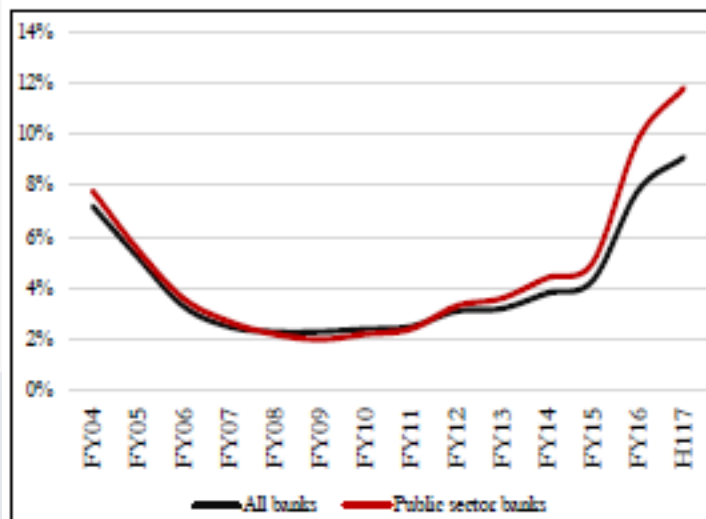


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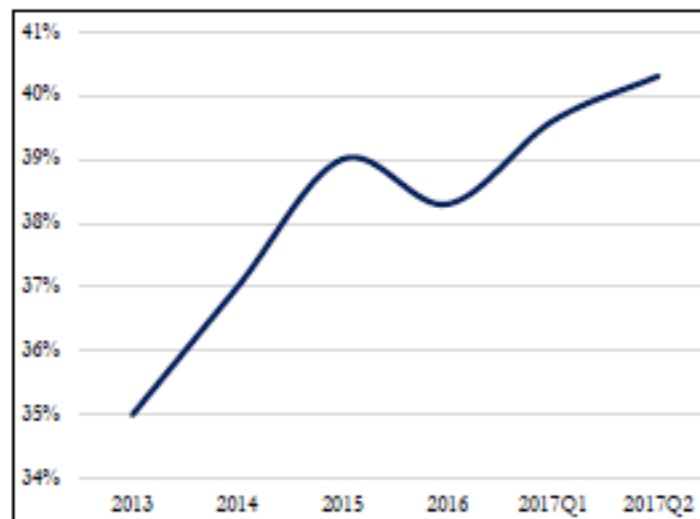
Chapter 4: The Festering Twin Balance Sheet Problem

- The Problem

**Figure 2. Gross NPA Ratio
(Per cent of Gross Advances)**



**Figure 3. Share of Debt Owed by
Stressed Companies***



Chapter 4: The Festering Twin Balance Sheet Problem

What went wrong?

- Increased debt
- Delays in projects
- GFC
- Inflation and MP



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Chapter 4: The Festering Twin Balance Sheet Problem

Indian characteristics?

- Reason
- Outcome: Impact on growth till date
- Driver of growth
- Structure of banking system
- Investment in past

Chapter 4: The Festering Twin Balance Sheet Problem

Handling of the crisis?

- Giving time : Is it sustainable?

The Focus on GROWTH

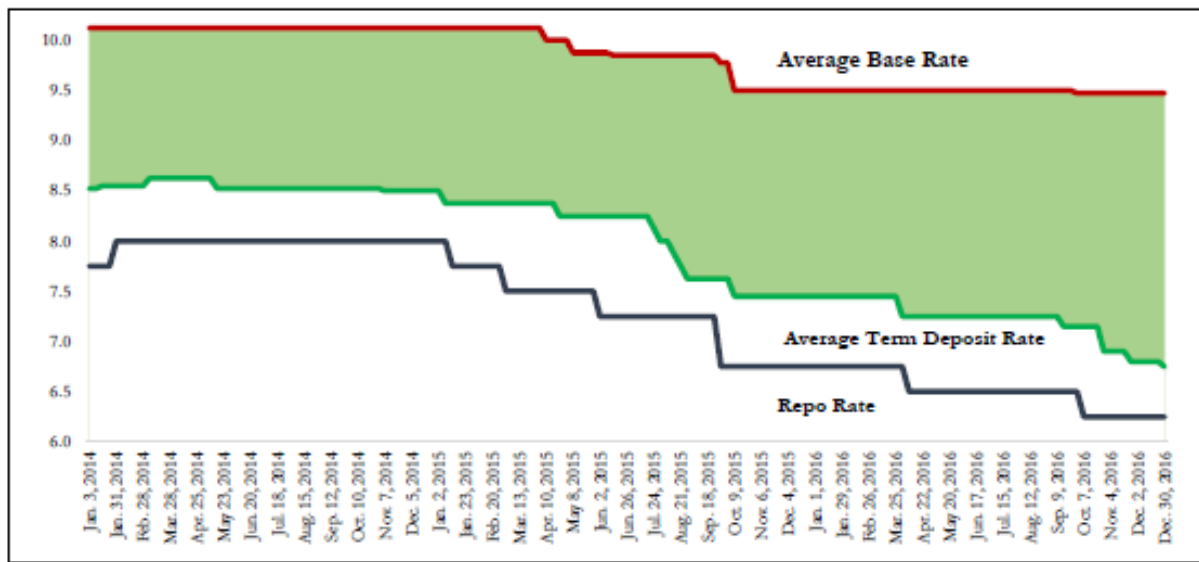
- Phoenix scenario
- Containment scenario
 - E.g. Power Sector (UPSC 2014)

Declining Spread, Revenue, Spreading of problem to MSME, falling investment

Chapter 4: The Festering Twin Balance Sheet Problem

Handling of the crisis? Banks and RBI – Taxing honesty

Figure 12. Repo, Base Lending Rate and Term Deposit Rate (Per cent)



Source: RBI. The base rate is the average of all banks. Average term deposit rate is for deposits of more than one year.

Chapter 4: The Festering Twin Balance Sheet Problem

Steps taken:

- ARC
- SDR
- S4A



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Chapter 4: The Festering Twin Balance Sheet Problem

Why have they not worked?

- Time and new system
- AQR
- Coordination
- Proper incentives for write downs
- Capital requirement



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Chapter 4: The Festering Twin Balance Sheet Problem

Laying down the case for a Public Sector Asset Rehabilitation Agency (PARA):

- Centralised Agency
- Inevitable losses- Minimise
- Funding of PARA – G-sec, Capital market, RBI
- Management

Chapter 4: The Festering Twin Balance Sheet Problem

Issues:

- There is a need to **confront the losses and accept the political consequences**.
- PARA should be highly professional with the sole objective of maximizing recovery value. It should be an **independent agency staffed by banking experts**.
- Although difficult and time consuming, **market pricing of the distressed loans** should be done to minimize losses.

Chapter 5: FISCAL FRAMEWORK - INDIA IS CHANGING, SHOULD INDIA CHANGE TOO



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Chapter 4: The Festering Twin Balance Sheet Problem

Recovery of growth:

1. Failure of unconventional monetary policies
2. Case for Countercyclical Fiscal policy – Addressing the bias towards deficit
3. Revisiting the FRBM

Chapter 11: ONE ECONOMIC INDIA: FOR GOODS AND IN THE EYES OF THE CONSTITUTION



Chapter 11: ONE ECONOMIC INDIA: FOR GOODS AND IN THE EYES OF THE CONSTITUTION

1. Economic integration of India – Inter-state trade
2. Results from the gravity model – distance decay, GDP size, language
3. Role of multiple taxes

- Constitutional provisions for free inter-state trade
- Comparison with:
 - US
 - EU
 - WTO

Case for GST

Questions?



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Thank you



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