Ministry of External Affairs
Economic Diplomacy Division

Subject: Economic Survey: 2016-17

The Union Finance Minister Shri Arun Jaitley presented the Economic Survey 2016-17 in the Parliament earlier today. A brief summary of the Economic Survey is placed below:

8 Interesting Facts about India:

i. Based on railway passenger traffic data, annual work-related migration in India is about 9 million people; double of what the 2011 census suggests.
ii. The level and change in the ratings received by India bear no resemblance to the dramatically different evolution in the level of, and change in, the underlying risks.
iii. Welfare spending in India suffers from misallocation.
iv. India's share of working age to non-working age population will peak later and at a lower level than that for other countries but last longer.
v. India has 7 taxpayers for every 100 voters, ranking 13th amongst 18 of our democratic G20 peers.
vi. As of 2011, India's openness – measured as the ratio of trade in goods and services to GDP has far overtaken that of China's.
vii. Spatial dispersion in income is still rising in India unlike the rest of the world.
viii. Evidence from satellite data indicates that India's metros are not able to collect property taxes effectively. For instance, Bengaluru and Jaipur collect just 5% to 20% of their potential property taxes.

Highlights of the Economic Survey:

- The year was marked by some tumultuous external developments. In the short-run, world GDP growth is expected to increase because of a fiscal stimulus in the United States but there are considerable risks. These include higher oil prices, and eruption of trade tensions from sharp currency movements, especially involving the Chinese yuan, and from geo-political factors. Another serious medium-term risk is an upsurge in protectionism that could affect India's exports.
- India's economic performance has been remarkable in the aggregate. Despite continuing global sluggishness, the Indian Economy has sustained a macro-economic environment of relatively lower inflation, fiscal discipline and moderate current account deficit coupled with broadly stable rupee-dollar exchange rate.
- As per the advance estimates (*based mainly on information for the first seven to eight months of the financial year*), the growth rate of GDP at constant market prices for the year 2016-17 is placed at 7.1%, as against 7.6% in 2015-16.
- Government final consumption expenditure is the major driver of GDP growth in the current year.
- Fixed investment (gross fixed capital formation) to GDP ratio (at current prices) is estimated to be 26.6% in 2016-17, vis-à-vis 29.3% in 2015-16.
- For 2017-18, it is expected that the growth would return to normal as the new currency notes in required quantities come back into circulation and as follow-up actions to demonetisation are taken. On balance, there is a likelihood that Indian economy may recover back to 6 ¾ per cent to 7 ½ per cent in 2017-18.
- Foreign exchange reserves are at comfortable levels, having have risen from around US$350 billion at end-January 2016 to US$ 360 billion at end-December 2016 and are well above standard norms for reserve adequacy.

- FDI inflows, which grew from 1.7% of GDP in FY2016 to 3.2% of GDP in the second quarter of FY2017, showed an upsurge and helped the balance-of-payments.
- Against the backdrop of robust macro-economic stability, 2016-17 was marked by two major domestic policy developments-the passage of the Constitutional Amendment, paving the way for implementing the transformational Goods and Services Tax (GST), and the action to demonetize the two highest denomination notes.
- The GST will create a common Indian market, improve tax compliance and governance, and boost investment and growth; it is also a bold new experiment in the governance of India's cooperative federalism.

Year of legislative accomplishments:

- The government overhauled the bankruptcy laws so that the "exit" problem that pervades the Indian economy can be addressed effectively and expeditiously.
- Codified the institutional arrangements on monetary policy with the Reserve Bank of India (RBI), to consolidate the gains from macroeconomic stability by ensuring that inflation control will be less susceptible to the whims of individuals and the caprice of governments.
- Solidified the legal basis for *Aadhaar*, to realise the long-term gains from the JAM trifecta (Jan Dhan-Aadhaar-Mobile).
- The Government enacted a package of measures to assist the textiles and garments sector that by virtue of being export-oriented, labour-intensive could provide a boost to employment, especially female employment.
- The National Payments Corporation of India (NPCI) successfully finalized the Unified Payments Interface (UPI) platform. By facilitating inter-operability, UPI has the potential to unleash the power of mobile phones in achieving digitalization of payments and financial inclusion, and making the "M" an integral part of "JAM."
- Additional FDI reform measures were implemented, allowing India to become one of the world's largest recipients of foreign direct investment.
- The government has also adhered to a steady and consistent path of fiscal consolidation.

Short-term macro-economic challenges:

- Re-establish private investment and exports as the major drivers of growth
- Reduce reliance on Government and private consumption.
- Address the Twin Balance Sheet problem - over-indebted corporates and bad-loan-encumbered public sector banks.

Long-standing meta-challenges:

- Inefficient redistribution
- Ambivalence about the private sector and property rights, and
- Improving, but still-challenged State capacity.

Twin Balance Sheet Problem:

- Gross NPAs has climbed to almost 12% of gross advances for public sector banks at end-September 2016. At this level, India's NPA ratio is higher than any other major emerging market, with the exception of Russia.
- Unexpected changes in the economic environment after the Global Financial Crisis, which caused timetables, exchange rates, and growth rate assumptions to go seriously wrong was responsible for the deteriorating situation.

- Credit growth to crucial sectors, especially to industry and medium and small scale enterprises (MSMEs) has reduced to levels unseen over the past two decades.
- NPAs of State banks increase the costs to the economy, by hindering credit, investment, and therefore growth.
- *Remedy*: Need for a professionally run central agency that could overcome the coordination and political issues that have impeded progress over the past eight years. Creating a Public Sector Asset Rehabilitation Agency (PARA) could help reduce the debt.

Fiscal:

- Indirect taxes grew by 26.9% during April-November 2016.
- The strong growth in revenue expenditure during April-November 2016 was boosted mainly by a 23.2% increase in salaries due to the implementation of the Seventh Pay Commission and a 39.5% increase in the grants for creation of capital assets.

Prices:

- The CPI based core inflation has remained sticky in the current fiscal year averaging around 5%.
- Inflation is being driven by narrow group of food items, of these pulses continued to be the major contributor of food inflation.

Trade:

- India has managed to maintain export competitiveness despite capital inflows and inflation that has been greater than in trading partners. Reflecting this, India's global market share in manufacturing exports has risen between 2010 and 2015.
- For the period 2016-17 (April-December), exports grew by 0.7% to US$ 198.8 billion and imports declined by 7.4% to US$ 275.4 billion.
- Trade deficit declined to US$ 76.5 billion in 2016-17 (April-December) as compared to US$ 100.1 billion in the corresponding period of the previous year.
- Region-wise, India's exports to Europe, Africa, America, Asia and CIS and Baltics declined in 2015-16. However, India's exports to Europe, America and Asia increased by 2.6%, 2.4%, and 1.1% respectively in 2016-17 (April-November period), while exports to Africa declined by 13.5%. USA followed by UAE and Hong Kong were the top export destinations for India.
- India's imports from Europe, Africa, U.S., Asia, CIS and the Baltics declined in 2015-16. However, in 2016-17 (April to November), imports from CIS and Baltics region increased by 10.3%, while imports from the remaining four regions declined. India's top three import destinations were China, followed by UAE and USA.

Current Account Deficit (CAD):

- The external position appears robust having successfully weathered the sizeable redemption of Foreign Currency Non-Resident (FCNR) deposits in late 2016, and the volatility associated with the US election and demonetization.
- The current account deficit (CAD) narrowed in the first half (H1) of 2016-17 to 0.3% of GDP from 1.5% in H1 of 2015-16 and 1.1% in 2015-16 full year.
- Robust inflows of FDI and net positive inflow of FPI were sufficient to finance CAD leading to an accretion in foreign exchange reserves in H1 of 2016-17.
- During 2016-17 so far, the rupee has performed better than most of the other emerging market economies.

External Debt:

- India's external debt stock stood at US$ 484.3 billion (end-Sept 2016), recording a decline of US$ 0.8 billion over the level at end-March 2016.

Agriculture:

- Agriculture sector is estimated to grow at 4.1% in 2016-17 because of the good monsoon rains compared to the previous two years.

Industry:

- Growth rate of the industrial sector is estimated to moderate to 5.2% in 2016-17 from 7.4% in 2015-16.
- The eight-core infrastructure supportive industries, viz. coal, crude oil, natural gas, refinery products, fertilizers, steel, cement and electricity registered a cumulative growth of 4.9% per cent during April-November 2016-17.
- The production of refinery products, fertilizers, steel, electricity and cement increased substantially, while the production of crude oil, natural gas fell during April-November 2016-17. Coal production attained lower growth during the same period.

Services:

- Service sector is estimated to grow at 8.9% in 2016-17, almost the same as in 2015-16.
- Significant pick-up in public administration, defence and other services, boosted by the pay-outs of the Seventh Pay Commission is estimated to push up the growth in services.

Demonetization:

- The adverse impact of demonetisation on GDP growth will be transitional. Once the cash supply is replenished, which is likely to be achieved by end March 2017, the economy would revert to the normal.
- The real GDP growth in 2017-18 is projected to be in the range of 6¾-7½ percent.
- Short-term costs: A contraction in cash money supply and subsequent, albeit temporary, slowdown in GDP growth;
- Long-term benefits: Increased digitalization, greater tax compliance and a reduction in real estate prices, which could increase long-run tax revenue collections and GDP growth.
- Weighted average price of real estate in eight major cities which was already on a declining trend fell further after November 8, 2016 with the announcement of demonetization. An equilibrium reduction in real estate prices is desirable as it will lead to affordable housing for the middle class and facilitate labour mobility across India currently impeded by high and unaffordable rents.
- Follow-up actions to minimize the costs and maximize the benefits include: fast, demand-driven, remonetisation; further tax reforms, including bringing land and real estate into the GST, reducing tax rates and stamp duties; and acting to allay anxieties about over-zealous tax administration. These actions would allow growth to return to trend in 2017-18, possibly making it the fastest-growing major economy in the world, following a temporary dip in 2016-17.

Demographic dividend:

- India seems to be a demographic sweet spot with its working age population projected to grow by a third over the next three decades providing it a potential the growth boost from the demographic divided which is likely to peak within next five years.

- Indian states have much lower levels of fertility than countries internationally. These unusually large declines in fertility will have implications for India's demographic dividend going forward.

Fiscal Prudence:

- The need for fiscal prudence, both by the Centre as well as the States to maintain overall fiscal health of the economy has been underlined.
- The Economic Survey states that the Centre's Fiscal Responsibility and Budget Management (FRBM) Act, was mirrored by Fiscal Responsibility Legislations (FRL) adopted in the States.
- There has been an improvement in the financial position of the States over the last few years. The average revenue deficit has been eliminated, while the average fiscal deficit was curbed to less than 3% of Gross State Domestic Product (GSDP). The average debt to GSDP ratio has also fallen.
- As the fiscal challenges mount for the states because of the Pay Commission recommendations, and mounting payments from the UDAY bonds, there is a need to review how fiscal performance can be kept on track. Incentivizing good performance by the States will require the Centre to be an exemplar of sound fiscal management itself.

Role of States:

- India's success as a federation depends on the progress of each of its individual states. One intuitive metric is to see how well individual states have done over time on two sets of indicators: economic indicators, such as income and consumption, and health/demographic indicators such as infant mortality rate, life expectancy, and total fertility rate.
- The Economic Survey mentions that when studying real per capita Gross State Domestic Product (GSDP) over time between 1983 and 2014, there has been a clear increase in levels indicating an across-the-board improvement. For example, between 1984 and 2014, the poorest state - Tripura, with a per capita income of INR 11,537 in 1984 increased its per capita GDP 5.6 fold to INR 64,712 in 2014; the median state (Himachal Pradesh) increased its income level 4.3 fold.
- Despite growing rapidly on average, there is sign of growing regional inequality among the Indian states. Moreover, unlike countries/provinces/states that start off poorer and subsequently grow faster, thereby closing the gap with more developed countries/states, the opposite is happening in India. A similar trend is noticed in consumption pattern also.
- The Economic Survey states that one possible hypothesis for seeing a regional dispersion in income and consumption is that there might be governance traps that impede the catch-up process. And if there are such traps, labour and capital mobility might even aggravate underlying inequalities.
- The Economic Survey remarks that in contrast, on health, there is strong evidence of convergence amongst the states in the 2000s. But here it is the international contrast that is striking. With regards to life expectancy, the Indian states are close to where they should be given their level of income. But that is not true of IMR (Infant Mortality Rate), suggesting that the "mother and child" (discussed also in last year's Survey) bear the brunt of weaker delivery of health services.

High levels of internal trade between states:

- India's internal trade-GDP ratio at about 54%, though not as high as that of the U.S (78% of GDP) or China (74% of GDP), but is greater than provincial trade within Canada and greater than trade between EU countries.
- However, the high level may be a consequence of the current system of indirect taxes which in some important cases perversely favours inter-state trade over intra-state trade. If true, the GST by ironing out these oddities will normalise inter-state trade in the country. This may reduce trade in some cases, and yet have a positive impact on tax revenue because of improvements in compliance, competitive enhancements and other channels.
- Smaller states Uttarakhand, Himachal Pradesh and Goa trade more; the net exporters are the manufacturing powerhouses of Tamil Nadu, Gujarat, and Maharashtra.
- Agricultural Haryana and Uttar Pradesh are also trading powerhouses because Gurugram and NOIDA, respectively, have become part of the great Delhi urban agglomeration.
- Intra-firm trade across States is surprisingly large (about 68% of inter-firm inter-state trade), and is affected by trade costs to a greater extent than inter-firm trade.

Labour migration:

- New estimates of labour migration in India have revealed that inter-state labour mobility is significantly higher than previous estimates and was particularly pronounced for females.
- Internal work-related migration using railways data for the period 2011-2016 indicate an annual average flow of close to 9 million migrant people between the states.
- Migration for work and education is accelerating.
- Language does not seem to be a demonstrable barrier to the flow of people.
- The patterns of flows of migrants are broadly consistent with what is expected - less affluent states see more out migration migrating out while the most affluent states are the largest recipients of migrants. Relatively poorer states such as Bihar and Uttar Pradesh have high net out-migration. Goa, Delhi, Maharashtra, Gujarat, Tamil Nadu, Kerala and Karnataka reflect net in-migration.
- *Recommendations*: The Survey calls for policy actions to sustain and maximize the benefits of migration. These include ensuring portability of food security benefits, providing healthcare and a basic social security framework for migrants – potentially through an inter-state self-registration process. While there do currently exist multiple schemes that have to do with migrant welfare, they are implemented at the state level, and hence require greater inter-state coordination.

Focus on Apparel and Leather & Footwear industry:

Meeting the challenge of jobs may require paying attention to labour-intensive sectors. The Survey dedicates an entire chapter to Clothes and Shoes: Can India Reclaim Low Skill Manufacturing? The highlights of this chapter are as follows:

- Apparel and Leather & Footwear sectors are eminently suitable for generating jobs that are formal and productive, providing bang-for-buck in terms of jobs created (especially for women) relative to investment and generating exports and growth.
- India is well positioned to take advantage of China's deteriorating competitiveness due to lower wage costs in most Indian states.
- Challenges faced by Indian companies:

a. Indian companies struggle in face of a set of common challenges related to logistics, labour regulations, tax & tariff policy and disadvantages emanating from the international trading environment compared to competitor countries.
b. Costs and time involved in getting goods from factory to destinations are greater in India than those for other countries.
c. Regulations on minimum overtime pay, onerous mandatory contributions that become *de facto* taxes for low-paid workers in small firms result in a 45% lower disposable salary, lack of flexibility in part-time work and high minimum wages in some cases.
d. Tax and tariff policies create distortions that impede India gaining export competitiveness. India imposes a 10% tariff on man-made fibers vis- a-vis 6% on cotton fibres. On the other hand, domestic taxes also favour cotton-based production rather than production based on man-made fibers, and leather footwear rather than non-leather footwear. The global demand for apparel is moving from cotton fibre products to manmade fibre and similarly footwear of non-leather, it adds.
e. India's competitors enjoy better market access by way of zero or at least lower tariffs in the two major importing markets, namely, the United States of America (USA) and European Community (EU).

- Measures suggested:
  a. Rationalization of domestic policies which are inconsistent with global demand patterns.
  b. An FTA with EU and UK in the case of apparel will offset an existing disadvantage by India's competitors- Bangladesh, Vietnam and Ethiopia. In the case of leather and footwear, the FTA might give India an advantage relative to competitors. In both cases, the incremental impact would be positive.
  c. The introduction of the GST offers an excellent opportunity to rationalize domestic indirect taxes so that they do not discriminate in the case of apparels against the production of clothing that uses man-made fibers; and in the case of footwear against the production of non-leather based footwear.
  d. A number of labour law reforms would encourage employment creation in these two sectors.

Cities as Dynamos:

- The last chapter of the Survey focuses on urbanization. Urban Indians now form about 1/3rd of the population – and they produce more than 3/5th of the country's GDP.
- Productive and healthy urbanization requires efficient public services delivery. But every Indian city faces serious challenges related to water and power supply, waste management, public transport, education, healthcare, safety and pollution.
- The 14th Finance Commission has recommended a grant of Rs. 87,000 crore to the municipalities for the period 2015-20, constituting of around Rs. 500 per capita per annum on average. The rest of the funds will have to be raised by the Urban Local Bodies (ULBs).
- The Survey suggests that municipalities need to adopt the latest satellite-based techniques to map urban properties. Property tax has been identified as a potential revenue source for ULBs going forward.
- Competition between States is becoming a powerful tool for change and progress, and that dynamic must extend to competition between cities.

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