NATIONAL SCHOOL OF BANKING

ECONOMIC SURVEY/2019-2020

HIGHLIGHTS OF THE ECONOMIC SURVEY - 2019-2020

A. PRELUDE -

The first Economic Survey of Prime Minister Narendra Modi's second term **commended the government on service delivery and macro-economic stabilisation** and projected growth of 7 per cent in 2019-20. While acknowledging that growth had slowed over 2018-19, it argued that was due to a base effect, a decline in government final consumption, low acreage of the rabi crop, and election-related uncertainty.

In terms of a practical reform agenda for Modi 2.0, **the Survey argued for a return to the basics: an investment- and exports-led growth strategy, such as has been perfected by the People's Republic of China. This would require a shift from depending on consumption demand to drive overall growth;** which in turn would mean that domestic savings and exports have to be energised. An aggressive export strategy would also solve the problem of current over-capacity plaguing private investment.

Key to increasing private investment would be further reductions in policy uncertainty. The Survey found that a **single quarter of increased policy uncertainty reduced investment growth for the following five quarters. It recommended a quarterly economic policy uncertainty index be tracked at the highest level**, and that quality assurance of processes in policymaking must be implemented in government via international quality certifications.

Boosts to the global competitiveness of Indian producers were also pushed. The Survey used the **example of Rajasthan to show that reforms of restrictive labour regulation can foster job creation and capital accumulation. Labour law and other small-scale promotion regulations created perverse incentives for firms to remain significantly smaller** in the Indian economic landscape with adverse consequences for jobs and growth. The Survey recommended shifting emphasis from protecting small industries to protecting young companies so as to incentivise growth.

Lower interest rates were also necessary, the Survey said, showing the **real rate has increased significantly in India and was higher than in its peer economies.**

- The Survey praised the government's performance on the provision of certain last-mile goods, combined with behavioural changes. **The Swachh Bharat Mission and the Beti Bachao, Beti Padhao were in line with the insights of behavioural economics**. Nudge-based policy that incorporated social and religious norms should now be extended to other fields of government action, including tax compliance and increasing household savings through the Jan Dhan Yojana.

India's legal system was the single biggest constraint to doing business in India and thereby fostering investment. It quoted India's rank of 163 in the World Bank's latest Ease of Doing Business Report for contract enforcement. The Survey argued that productivity will need to increase by 24.5 per cent, 4.3 per cent and 18 per cent for lower courts, high courts and the Supreme Court respectively but added that the use of technology, increase in working days and administrative/process reforms can enable these ambitious yet achievable efficiency gains.

Chapters in the Survey made specific recommendations related to **energy, minimum wages and data policy.** The Survey calculated that there were currently 1,915 different minimum wages in place in India. **It suggested instead four categories - unskilled, semi-skilled,**

skilled, and highly skilled - based on geographical region, covering all workers. On data policy, the Survey said the **government must intervene to create data as a public good,** in part by merging distinct data sets and sharing the consequences with the private sector within the legal framework of data privacy. On energy, the Survey predicted that **per capita energy consumption in India would quadruple, and that an Indian city could perhaps emerge as a Detroit for electrical vehicles in the future.**

A chapter on demographics pointed out that population in the 0-19 age bracket has already peaked. **Many states were already had total fertility rates below the replacement rate, and the national TFR would be below replacement level by 2021. Preparing for this demographic transition would require raising the retirement age, improving health care access, and shifting emphasis from quantity to quality in education.**

B. SURVEY HIGHLIGHTS -

1. **NEW OUTLOOK : 8% annual growth needed for GDP to touch $5 trillion by FY25; CEA PEGS FY20 growth at 7%.**

   Survey Tailors Growth Model for India :

   Revenue, PM-Kisan hurdles for fiscal consolidation :

   The survey said expenditures for various schemes without deviating from the newly revised fiscal glide path remain the foremost challenge. It said the several challenges on the fiscal front in the FY20 include revenue implications on account of apprehensions of slowing of growth, revenue buoyancy of the GST and provisioning for schemes such as PM-KISAN.

2. **PRIVATE INVESTMENT :** Government must ensure predictable policies.

   Cut rates, encourage savings :

   With private companies reluctant to invest in fresh capacity, the Economic survey has suggested **apart from reducing interest rates and encouraging savings, the government must ensure predictable policy for India Inc.**

3. **POLICY & RULES :** Keep timeframes same, monitor uncertainty Index.

   Underscoring policy uncertainty :

   The Economic Survey 2018-19 made a case for reducing what it calls economic policy uncertainty in India, by making policy and rules more predictable and stable, properly documenting the implementation of policy, and following an economic policy uncertainty index.

4. **SMALL INDUSTRIES :** 'DWARFS' account for more than half of organised firms; Time for 'Infants'.

   Survey calls for 'sunset' clause on policy incentives to MSMEs :

   The Economic Survey has pitched for a sunset clause on policy incentives given to small firms and asked the government to handhold infant or new firms rather than dwarfs - a term used by Chief Economic Advisor Krishnamurthy Subramanian to describe firms that never grow beyond their small size.

   Job creation in India suffers from policies that foster dwarfs, that is small firms that never grow, instead of infant firms that have the potential to grow and become giants rapidly, the survey said, categorising **small firms as those employing less than 100 workers. Dwarfs were defined as small firms in operations since more than 10 years and infants as newer companies that are small in size in terms of workforce**, according to the survey.

Impact of Deregulation of Labour Market In Rajasthan :

The Economic Survey made a strong pitch for flexible labour laws to boost growth and employment, creating a distinction between flexible and inflexible states, in terms of rigidity on labour laws. Rajasthan's labour law reforms was a specific case in point.

5. COMPENSATION : Minimum wage law has no adverse impact on job creation.

Simpler Minimum Wage System to Boost Inclusion :

A simple and effective minimum wage system is an urgent necessity for India's inclusive growth, according to the Economic Survey of 2018-19.

A well-designed minimum wage system can be a potent tool for protecting workers and alleviating poverty, if set at an appropriate level that ensures compliance. International experience has shown that **relatively simple systems are more effective and usually complex systems are least effective**, the survey said.

The survey brought to light the gender discrimination through the present minimum wage legislations and that the law had no adverse impact on job creation In fact, this **leads, to higher income levels in low-paid and informal sector jobs.**

The survey **supported the Code on Wages Bill,** which was approved by the Union Cabinet on 3rd July 2019, to rationalise minimum wages in the country.

6. ACCESSING DATA : Aim is to improve targeting in welfare schemes.

Govt. can monetise Citizen Data :

The Economic Survey suggested the government monetise citizens' data as part of its larger plan to use it as a public good. Making the case for digital storage and processing of data, the Survey said technology brought down the cost and effort of data collection, storage, processing and dissemination.

Data is generated by the people, of the people and should be used for the people. As a public good, data can be democratised and put to the best possible use, it noted.

The Survey proposes improving the delivery of government services by building on the administrative, survey, institutional and transactions data that the citizens willingly or lawfully share with the government.

Data As Public Good :

Gathering :

- Digitise existing paper-based data
- Initiate digital data collection at source

Storing :

- Initiate real-time storage for select data
- Reduce time lag between collection and data entry

Processing :

- Build capacities of govt bodies to analyse data
- Involve private sector in analysis and insight generation

Disseminating :

- Create scheme dashboards
- Open district-level dashboard to the public
- Open data from third-party studies to the public.

7. **PRICE RISE ANALYSIS :** CPI Inflation had dipped in FY19, courtesy low growth in food prices.

Tuition, Doctor Fee Contribute Most To Inflation :

In a first-of-a-kind analysis of price rise in important services, the Economic Survey has shown that private tuition fees, doctors' fees, bus fares and telephone charges were the areas that contributed the most to consumer inflation in the fiscal year 2018-19 (FY19).

This analysis has been done from Labour Bureau estimates of consumer price index inflation for industrial workers (CPI-IW). This is an important insight into price situation in the economy, especially when inflation in health and education was more than the average general consumer price index-based (CPI) inflation. General CPI inflation had dipped in FY19 courtesy **low growth in food prices.**

8. **MGNREGS :** Direct benefit transfer improved wage payment and reduced distress among vulnerable sections.

Aadhaar-linked Payments Checked Leakages :

The Economic Survey 2018-19 has criticised the execution of the Mahatma Gandhi National Rural Employment Generation Scheme (MGNREGS) under previous governments and described how things improved after Aadhaar-linked payments (ALP), tied with Jan-Dhan accounts, were introduced in 2015.

Chief Economic Advisor (CEA) K.V. Subramanian has given a chapter in the Economic Survey - his first - to **highlight how direct benefit transfer (DBT) in the MGNREGS has improved wage payment, raised the number of muster rolls filed, increased the demand for and supply of work, and reduced distress among vulnerable sections. More importantly, it has checked leakages in the scheme by eliminating ghost workers,** the Survey said.

The Survey advocated creating a real-time data base of rural distress, using the MGNREGS job demand data.

9. **CHEAPER FINANCE :** Time to significantly lower cost of capital.

Need Modest Real Interest Rates :

The Economic Survey for 2018-19 **stressed the need to lower real interest rates to give a boost to private investment,** something that was proposed by a member in the Reserve Bank of India's (RBI's) monetary policy committee (MPC).

The real interest rate is the difference between the lending rate (the Survey took State

Bank of India's base rate) and the prevailing inflation rate. Similarly, the real policy rate is the repo rate minus inflation.

Considering the latest inflation print at 3.4 per cent, while the repo rate is 5.75 per cent, and the SBI base rate is 9.05 per cent, the real policy rate works out to 2.35 per cent, while the real interest rate is roughly 5.65 per cent.

Both the real interest rate and the real policy rate are way above India's competitors. The Economic Survey made a strong pitch to bring them down.

There are various views on what an ideal real policy rate for India should be. The consensus seems to be 1.5-2 per cent. This means at the current inflation rate, which is expected to remain till December at least, the repo rate has the scope to go down by another 35 basis points. The Economic Survey noted that the real rate of interest had increased significantly in India over the years.

The cost of capital for Indian firms is one of the highest in the world. This affects investment prospects in the country. The rates can touch nearly 20% for some sectors such as trucking, where the comparable rate is just above 5% in Japan and less than 10% in China.

10. IBC IMPACT : Cultural Shift In Ecosystem :

The Economic Survey said while the sustainable impact of the Insolvency and Bankruptcy Code (IBC) would be known in due course, green shoots had already emerged and some significant benefits of the IBC were visible. **The threat of promoters losing control of the company or protracted legal proceedings is forcing many corporate defaulters to pay off their debt even before insolvency can be started,** it said.

Till 31st March 2019, the corporate insolvency resolution process yielded a **resolution of 94 cases, which has resulted in the settlement of claims of financial creditors totalling Rs.1.73 trillion. These cases include six out of 12 large accounts where insolvency resolution was initiated by banks, according to the directions of the RBI in 2017. The overall recovery in case of resolved cases is nearly 43 per cent, which is 194 per cent of the liquidation value, the Survey said.**

In the two years of the IBC, **real estate was the top sector, with 20 per cent of the insolvency cases being registered. Manufacturing, which includes steel, power and chemicals, comprised 40 per cent**. A large number of firms also opted for voluntary liquidation. One of the objectives of the Code was to give companies a chance to exit if they did not carry out any business or if the business itself was unviable.

NBFC Stress Poses Risks To Growth, Says Survey :

The Economic Survey for 2018-19 highlighted contagion risks posed by stress in non-banking financial companies (NBFCs). It has hurt consumption growth in the automobile sector affecting manufacturing, the Survey said.

It **warned that if the impact of the stress in the NBFC sector spilled over 2019, it might lead to lower credit offtake from NBFCs, which might impede consumption spending growth. The Survey charted the origin of the NBFC crisis to mutual funds' (MFs') risk aversion after the IL&FS crisis in September.**

Immediately after the IL&FS crisis, **NBFCs faced a severe liquidity crunch as MFs**

stopped refinancing the loans of NBFCs, the Survey said. It added MFs' deployment **towards NBFCs stood at -12 per cent in April.**

Banks' attempts to provide liquidity after the IL&FS crisis were short-lived as the Survey pointed out that resources from the banking side started contracting from November 2018.

This squeeze in the f**low of resources to NBFCs has affected the lending capability of the sector in recent quarters, the Survey read. Credit growth in NBFCs in March 2018 stood at 30 per cent on a year-on-year (YoY) basis. In March 2019, it was at 9 per cent (YoY). The Survey showed how some key performance indicators of NBFCs had deteriorated in 2018-19. The return on assets for the NBFC sector was down at 1.4 per cent in December 2018, from 1.6 per cent in March 2018. The capital to risk asset ratio or capital adequacy slipped to 22.2 per cent, from 22.8 per cent in the same period.**

Net non-performing assets of NBFCs were up at 3.6 per cent from 3.2 per cent. The return on equity for the sector slipped to 6.1 per cent from 7 per cent.

In August 2018, **MFs put in Rs.1.3 trillion in short-term paper (**of less than 90 days) that NBFCs had issued. By the end of 2018-19, **it had dropped to Rs.95,708 crore,** showed the data sourced from Sebi. This shows a f**all of 27 per cent.**

11. HOUSEHOLDS ARE SPENDING MORE ON DISCRETIONARY ITEMS :

Indians are increasingly spending more on discretionary items and less on basic necessities such as food, according to the Economic Survey for 2018-19.

Private consumption forms the biggest chunk in the gross domestic product (GDP) basket. Changes in consumption pattern are crucial to the growth dynamics of various sectors of the economy.

The last two quarters of 2018-19 saw growth slowing in private consumption - contracted auto sales and subdued FMCG sales - pushing down economic growth to the lowest in 20 quarters. **Private final consumption expenditure,** the way it is defined in national income accounts, **forms nearly 60 per cent of India's GDP**.

Although the share of private consumption in GDP remains high, the **pattern of consumption has undergone some change over time - from essentials to luxuries and from goods to services, the Survey said.**

The trend is important as it gives a hint about the outcome of the Consumption Expenditure Survey (CES), which will be released by the National Statistics Office within a month or two. The CES forms the basis for deciding the **sources and weights of private consumption** expenditure in the national accounts; the data that is used for GDP formulation.

From food and beverages, transport and communication, which are more of necessities, the spending has been shifting towards clothing and footwear, health and education, and housing and maintenance, the Survey said.

The data from the NSO shows the s**hare of food and beverages has reduced from 33.2 per cent of private consumption in 2011-12 to 30 per cent in 2017-18 a reduction of over three percentage points.**

12. **PUSH COMES TO NUDGE :** Deploy behavioural economics, religious norms to achieve goals.

Giving Change A Big 'Nudge' -

From citing religious tenets and making people repay their debts to improving efficacy of social welfare programmes, such as financial inclusion, the Economic Survey 2018-19 has emphasised that the government deploy behavioural economics as a tool to improve outcomes. This branch of economics has gained traction in policy making in recent times, and earned more popularity after economist Richard H Thaler, popular for his work on 'Nudge' theory, won the Nobel Prize in 2017.

The chief economic advisor, Krishnamurthy Subramanian, has given a chapter to utilising insights from this branch of economics in furthering government's social and economic objectives. He noted the **government had already deployed the concepts and principles of behavioural economics to get better results from schemes, such as Swachh Bharat Abhiyan and Beti Bachao Beti Padhao.**

13. **'DEMOGRAPHIC DIVIDEND' ON THE DECLINE :** Increase in retirement age could be considered.

India is set to witness a sharp slowdown in population growth in the next two decades, the Economic Survey report has flagged. It says that although the country as a whole will enjoy the demographic dividend phase, some states will start transitioning to an ageing society by 2030s. With life expectancy for both males and females is likely to continue rising, increasing the retirement age for both men and women going forward could be considered in line with the experience of other countries. **Population growth in India has been slowing in recent decades from an annual growth rate of 2.5 per cent during 1971-81 to an estimated 1.3 per cent as of 2011-16. Going with the trend, the Survey suggests that policy makers need to prepare for ageing, which will need investments in health care as well as a plan for increasing the retirement age in a phased manner.**

14. **SURVEY CALLS FOR COORDINATING BODY FOR RESOURCES EFFICIENCY :**

FOR A GREENER TOMORROW :

- The Survey suggests setting up of a coordinating body for environment and sustainability concerns.
- National policy on resource efficiency.
- **A policy on sustainable public procurement to minimise consumption of resources, reduce waste generation, green house gas emissions.**
- An energy policy taking into consideration the economies of coal and renewable.

C. THE SURVEY HAD A SERIES OF SHORT NOTES ON ECONOMIC POLICY ISSUES -

TAX COMPLIANCE :

- **Automatic deduction of tax and directing all or portion of refunds into savings accounts can be used to encourage savings, including retirement savings.**
- Public shaming of individuals who don't pay taxes can reduce non-compliance.
- Top 10 highest tax payers within a district can be accorded due recognition in the form of expedited boarding privileges at airports, fastlane privileges, special diplomatic type lanes at immigration counters and others.

- **Highest taxpayers over a decade could be recognised with important buildings, monuments, roads, initiatives and others being named after them. Propagate the social norm that paying taxes honestly is honourable.**

RELIGION/SPIRITUAL NORM :

- Repayment of debt in one's own life is prescribed as necessary by scriptures across religions. Given the importance of religion in the Indian culture, the principles of behavioural economics need to be combined with this spiritual/religious norm to reduce tax evasion and wilful default in the country.
- **Practising religion without developing an embedded sense of sacrifice, empathy and humility to serve the needs of other people is self-defeating.**
- Repeatedly reinforcing examples of people following these positive sentiments as truly spiritual people can help establish the correct social norm that serving man is serving God.

MINIMUM WAGES :

- The present minimum wage system in India is complex with 1,915 minimum wages defined for various scheduled job categories across various states.
- One in every three wage workers in India is not protected by the minimum wage law.
- **Minimum wages should be fixed for four categories, namely, unskilled, semi-skilled, skilled and highly skilled, based on the geographical region and should cover all workers, irrespective of any wage ceilings.**

EXTERNAL DEBT :

- **At $521.1 billion at end-December 2018, it was 1.6 per cent lower than its level at end-March 2018. The critical external debt indicators reflect that India's external debt is not unsustainable.**
- **The total liabilities-to-GDP ratio, inclusive of both debt and non-debt components, has declined from 43 per cent in 2015 to about 38 per cent at the end of 2018. The share of foreign direct investment has risen, and that of net portfolio investment has fallen in total liabilities, thereby reflecting a transition to more stable sources of funding the current account deficit.**
- The income terms of trade, a metric that measures the purchasing power to import, has been on a rising trend, possibly because the growth of crude prices has still not exceeded the growth of India's export prices.

SERVICES SECTOR :

- **Services sector (excluding construction) has a share of 54.3 per cent in India's GVA and contributed more than half of GVA growth in 2018-19.**
- India's services sector does not generate jobs in proportion to its share in GVA. **Services share in employment is 34 per cent in 2017** which is significantly less than its share of 54 per cent in GVA.
- **During 2018-19, FDI equity inflows into the service sector fell by $696 million or 1.3 per cent from the previous year to about $28.26 billion.**

D. CONCLUSION -

In his first Economic Survey as India's chief economic advisor, K V Subramanian has successfully infused a conservative and well-understood set of recommendations with a novel, and even indigenous, air.

The Survey has given the policy directions a new freshness and embedded them in a view of recent economic successes in India that will be persuasive to political decision-makers. **The Survey has also clearly - and correctly - poked a hole in the conventional wisdom that India must rely on consumption-driven growth by putting investment, and particularly private investment, at the centre of its strategy. As a consequence, its strategy also must prioritise export growth.**

An increase in investment has to be paid for with a corresponding increase in savings, unless the current account deficit were again to explode. But in recent years the private corporate sector has essentially closed its internal savings-investment gap; and **it is the household sector, which includes small and unincorporated enterprises, that is the primary net saver of the economy.** The problem is where this is going. Net borrowing by the public sector - the central and state government's budgetary and off-budget borrowing - is estimated to have grown at an average of over 10 per cent a year since 2011-12. It is, at this point, no less than an identity: **For private investment to recover, government dis-saving must be reduced**. **The government will have to spend less or raise more in revenue.**

A granular understanding of the **reasons for the crisis in private investment** underlies Dr. Subramanian's choice of subjects in the Survey. For one, there is **clearly continuing policy uncertainty** in the Indian economy, in spite of there being the confidence provided by a stable government with a working majority. This must be addressed - the Survey **suggests transparent, independent quality assurance of policy - making processes**, but other possibilities exist. **Legal and administrative reform, alongside the preservation of institutional independence, will also aid in decreasing policy uncertainty**. Crucial also is the long-delayed question of **judicial reform**, which would make **dispute settlement and contract enforcement** in India less of a nightmare. **Real interest rates are too high, and need to come down.**

Regressive policy, which creates perverse incentives for companies and encourage them to stay small and inefficient, must be phased out, and replaced with **preferences for newer rather than smaller enterprises** - the Survey correctly points out that **it is the former and not the latter that generate growth and jobs**. Finally, **the competitiveness of exporters must be priority** - measured through the average productivity of firms in the economy. This, of course, **requires labour law reform**, and **the Survey makes this point clearly and concisely**, embedding it in a defence of the **outcomes produced by Rajasthan's labour reforms in 2014. The one missing piece is rupee depreciation**. The Survey, in a footnote, argues that this is unnecessary to boost exports. But fixing an overvalued currency is the simplest and cheapest way to gain a competitive boost, which should have been considered.