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INDIA DEVELOPMENT UPDATE

Towards a higher growth path

April 2015

WORLD BANK GROUP
Macroeconomics & Fiscal Management

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1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

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Preface

The India Development Update has two main aims. First, it reports on the key developments over the past six months in India's economy, and places these in a longer term and global context. Based on these developments and on policy changes over the period, it updates the outlook for India's economy and social welfare. Second, the Update provides a more in-depth examination of selected economic and policy issues, and analysis of medium-term development challenges. It is intended for a wide audience, including policymakers, business leaders, financial market participants, and the community of analysts and professionals engaged in India's evolving economy.

This Update was prepared by Poonam Gupta (DEC), Frederico Gil Sander, Smriti Seth, Saurabh Shome, and Jaba Misra (GMFDR) under the guidance of Shubham Chaudhuri (Practice Manager, GMFDR); Neeti Katoch (GFMDR) authored the financial sector analysis, Shrayana Bhattacharya and Rinku Murgai (GPVDR) authored the section on MGNREGS. Valuable inputs from Tehmina Khan, Marc Stoker, Supriyo De (DECPG), Anuradha Ray and Varsha Marathe Dayal (GFMDR); and discussions and suggestions from Denis Medvedev are gratefully acknowledged. Poonam Gupta acknowledges timely and diligent help on the data and charts from Serhat Solmaz (DEC). Onno Ruhl (Country Director, SACIN), Satu Kahkonen (Director, GMFDR) and Marcelo Giugale (Senior Director, GMFDR) provided overall strategic direction and guidance to the team.

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Executive summary

1. The government has announced ambitious development goals and concerted reform measures in encompassing areas

After a decisive election victory in May 2014, the government has set ambitious development goals, seeking to transform India into a "prosperous" nation

The development agenda, described in the annual budget as "vision 2022", seeks to ensure employment, economic opportunity, housing, electricity, water, sanitation, connectivity, medical facility and schools for all its people by 2022, the 75th year of India's independence. A three pronged strategy underpins this vision--fast and durable economic growth, especially in manufacturing, supported by a stable macroeconomic environment; involving the States as active development partners in a move toward "cooperative and competitive federalism"; and improving the delivery of social benefits while extending the social safety coverage to the elderly, and the underprivileged.

The government has started implementing reforms spanning a number of areas to achieve these goals

Reforms include efforts to improve the business environment; liberalization of FDI; enhancing investment in infrastructure; speedier resolution of corporate disputes; and simplified and lower corporate taxation. It has devolved more resources and spending discretion to the States in the Budget for 2015-16; free up some fiscal space through fuel tax and subsidy reforms; and strove to improve the quality of public expenditure. The government reiterated its resolve to implement the GST by April, 2016, widely expected to increase India's tax-to-GDP ratio by at least a couple of percentage points. Some progress has been made on weaning the delivery of social benefits from price based subsidies and in-kind transfers toward direct transfer of benefits. The new models of delivery, to be channeled through bank accounts, mobile phones, and the biometric identity of the beneficiaries, are expected to improve targeting and reduce inefficiencies and leakages. Commensurately, 125 million bank accounts have been opened in a short span of time; while the coverage of the biometric based Unique Identification is being extended to cover the entire population.

2. The economy seems to have turned the corner, and the economic outlook has improved significantly

Aided by a supportive external environment, in particular the sharp decline in oil and commodity prices, the economy has taken strong strides towards higher growth and enhanced stability

The economy has been on an upturn in the last three quarters--growth has accelerated, inflation has declined, current account deficit has narrowed, and external buffers have been replenished. GDP growth (at market prices) is projected to accelerate to 7.2 percent in 2014-15, compared to 6.9 percent in the previous year. On the production side, growth is driven by the services sector, which continues to outperform manufacturing; and on the expenditure side, it is driven by public and private consumption, with modest contributions from investment and exports. Underpinned by the global trends, inflation declined to 4.6 percent during the second half of 2014-15 from an average of 7.3 percent in the first half of the year. The decline in inflation and fiscal restraint generated some room for monetary accommodation, making it possible for the RBI to lower the policy rates twice in the last quarter of 2014-15.

The fiscal deficit target of 4.1 percent of GDP in 2014-15 is

The deficit target for 2014-15 is likely to be met despite weak revenue collection, primarily by compressing current and capital expenditure. Deviating from recent trends, the recently announced budget for 2015-16 proposed to improve the quality

expected to be met; followed by a modest consolidation in 2015-16

of expenditure by increasing capital expenditure by about 0.2 percent of GDP next year; while allocating a larger share of tax revenue to the States, along with greater spending discretion. There was some decline in fuel subsidies, due to subsidy reforms as well as the decline in the price of oil. Meeting the budgeted fiscal targets for 2015-16 would depend on the realization of tax buoyancy assumed in the budget, as well as the targets for disinvestment receipts, and the assumptions on oil prices and growth outcomes. The government slowed down the pace of medium term fiscal consolidation to make room for "funding infrastructure investment", proposing to consolidate the deficit to 3 percent of GDP in the next three years, instead of two as was proposed in the previous budget; setting the glide path of deficit to 3.9 percent, 3.5 percent and 3.0 percent respectively in 2015-16, 2016-17 and 2017-18.

Balance of payment outlook improved during the year

While the decline in the price of oil helped contain the oil import bill; moderation in the price of gold and restrictions on gold imports helped restrain the import of gold. Both these developments restrained the trade deficit to $112 billion in the first three quarters of 2014-15, compared to $117 billion over the same period in the previous fiscal year. With the steady stream of remittances and services exports, the current account deficit was curtailed at $26 billion in the first three quarters of the fiscal year, compared to $31 billion over the same period in the previous year. The RBI refurbished its reserve buffers, increasing it by nearly $40 billion during the year to $338 billion as of February 27, 2015.

GDP growth (at market prices) is expected to accelerate to 7.5 percent in 2015-16 reaching 8.0 percent in 2017-18[1]

Acceleration in growth is conditional on the rate of investment picking up to 11 percent during FY2016-FY2018. [2] Pace of growth of government consumption expenditure is expected to increase in 2015-16 on account of the anticipated revision in public salaries under the ambit of the 7th Pay Commission; and private consumption expenditure is expected to respond gradually, increasing to 9 percent by 2017-18 from 6.1 percent in 2014-15. Low crude prices, improved production capacity, and the adoption of the flexible inflation targeting framework, would likely keep inflationary pressures under check, inflationary expectations anchored and help prevent overheating in the medium-term.

Global growth remains contained, marred by below average growth in crucial economic partners of India

Global growth is expected to pick-up modestly this year, but less than previously anticipated. Several countries and regions with strong trade, diaspora and investment links with India continue to face a soft growth patch, dampening the external outlook. Countries that figure most prominently among large destinations for Indian exports as well as its diaspora, such as the UAE, Saudi Arabia, the broader set of GCC, but also China and Europe, face subdued growth prospects. These could translate into some slowdown in remittances, and possibly in FDI flows into India, while undermining the prospects for resurgence in exports growth.

3. There are external as well as domestic risks to the outlook

The recent economic turnaround and the outlook rest crucially on oil and commodity prices

The current economic narrative, described in the Economic Survey as India being in a "sweet spot", characterized by decline in inflation; and current account deficit; and fiscal restraint, derives partly from the recent sharp decline in the international prices of oil, metals and food. This narrative could alter if prices fail to stay low, reinforcing the imperative for the government to insulate the economy even more

[1] Forecasts are made using the revised (base year: 2011-12) national accounts series. The official series only goes back till 2011-12, we back-casted the series to 1960 using growth rates.
[2] FY2016 refers to the fiscal year ending 31st March 2016.

remaining low

determinedly from the global price of oil. This could be done by weaning the fiscal outcomes more fully from oil prices; by reducing the intensity of use of imported oil, while encouraging alternative sources of energy; by mulling the possibility of creating additional fiscal buffers by using petroleum taxation more actively, as well as by appropriating the current sweet spot moment to further rationalize the still high levels of subsidies on food and fertilizer.

India remains at risk of disruptive impact on its exchange rate and financial markets from potential tightening of the US monetary policy

Even though the Federal Reserve Board has continued to maintain its stance on monetary policy, the expectations are that it would start the tightening phase sometime soon, and possibly as early as in summer, 2015. India being one of the larger financial markets and a large recipient of capital flows, could be adversely affected by a rebalancing triggered by the tightening of the Fed's monetary policy.[3] While the Reserve Bank of India has taken preventive measures to reduce external vulnerability, and has built international buffers as a "first line of defense"; the risk remains, warranting vigilance.

With the potential for rapid export growth constrained by both supply and demand conditions in near term, the case for structural reforms and stepping up infrastructure is even more compelling

On the supply side, Indian merchandise exports have not been able to keep pace with the growth in world exports in the past, reflected in the share of Indian exports in world exports remaining stagnant. On the demand side, the share of world exports to world GDP seems to have peaked. It would take a level increase in the competitiveness of Indian manufacturing for it to carve a space for itself among the existing large exporters, within a market that seems to have peaked out. Among the many preconditions for India to improve its competitiveness are an infrastructural boost to bring it at par with the current manufacturing hubs in the world; competitive supply of all factor inputs, such as labor, land, finance, and skills; and a competitive business environment.

Amidst thin fiscal space, there is limited scope for public investment to help bridge the infrastructure deficit; unlocking private investment would be crucial

With a stubbornly low tax-to-GDP ratio, alternative channels of long term investment need to be explored while reviving the PPP model of financing to meet India's yawning infrastructure gap. Simultaneous efforts to increase the tax-to-GDP ratios, through the timely implementation of the GST, as well as complimentary measures to improve tax administration and compliance could generate additional fiscal space in the years ahead. The outlook for new investments continues to be dented by the debt overhang in the corporate balance sheets, which has extended to the Public Sector Banks (PSB). The banks' balance sheets are currently marred by high Non-Performing Loans, low profitability, and subdued credit growth, and may not be able to support higher demand for credit if the investment cycle were to turn around. While some measures have been announced to strengthen the balance sheets of the PSBs and to improve their operational efficiency, more decisive measures would be needed given the underlying magnitude of the recapitalization requirement and other medium term ownership related issues.

The pace of reforms would need to be maintained or even stepped up to meet the development objectives

The government has embarked on energetic progress in several policy areas. The pace of these efforts would need to be maintained or even stepped up to unleash the productivity and scale enhancement needed for the Indian firms to become globally competitive. As has been suggested elsewhere, devolving more policy space to the states may produce enclaves of competitiveness and help garner further support for wider reforms among the population and political classes across India.

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3 See Eichengreen, Barry and Gupta, Poonam, 2014, "Tapering talk: the impact of expectations of reduced Federal Reserve security purchases on emerging markets", Policy Research Working Paper 6754, The World Bank.

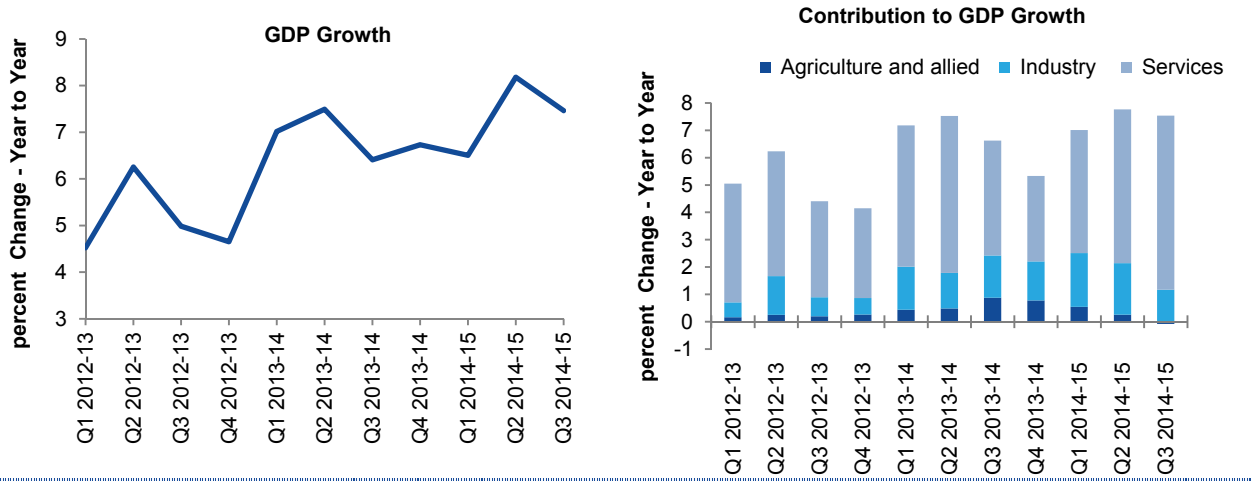
A. Recent Economic Development and Outlook

1. Real Sector Activity

Economic activity strengthened in 2014-15

GDP growth (at market prices) accelerated to 7.4 percent during the first three quarters of 2014-15, compared to 7 percent during the same period last year. On the production side, the services sector, accounting for nearly half of total GDP, continued to be the largest contributor to economic growth, with a distinct acceleration in growth in the second and third quarter of 2014-15, to 10.1 and 13.5 percent respectively (Figure 1). Within services, growth was driven by a sharp acceleration in public administration and defense (growing at 20 percent yoy in the third quarter, compared to an average growth of 4 percent during the first two quarters), as well as the continued buoyancy in financial services and real estate services (growth of 13.8 percent yoy) in the first three quarters of 2014-15.

Figure 1: GDP Growth Accelerated in 2014-15, with the Service Sector making the largest Contribution
(percent change, yoy)



Source: Central Statistical Office, India

Industrial production revived during 2014-15

Industrial output, which accounts for nearly one-third of GDP, accelerated by 5.3 percent during the first three quarters of 2014-15, compared to 4.6 percent last year, and 2.7 percent in the year before. The manufacturing sector (with a weight of 18 percent in GDP) grew at a steady 5.4 percent in the first three quarters of the fiscal year. The trend of revival was also reflected in high frequency indicators of industrial production—the Index of Industrial Production, grew by 2.6 percent yoy during Apr-Dec 2014, from stagnant output in the previous year. While utilities grew at a robust 9.6 percent during Apr-Dec, 2014, construction growth slowed in the third quarter of 2014-15.

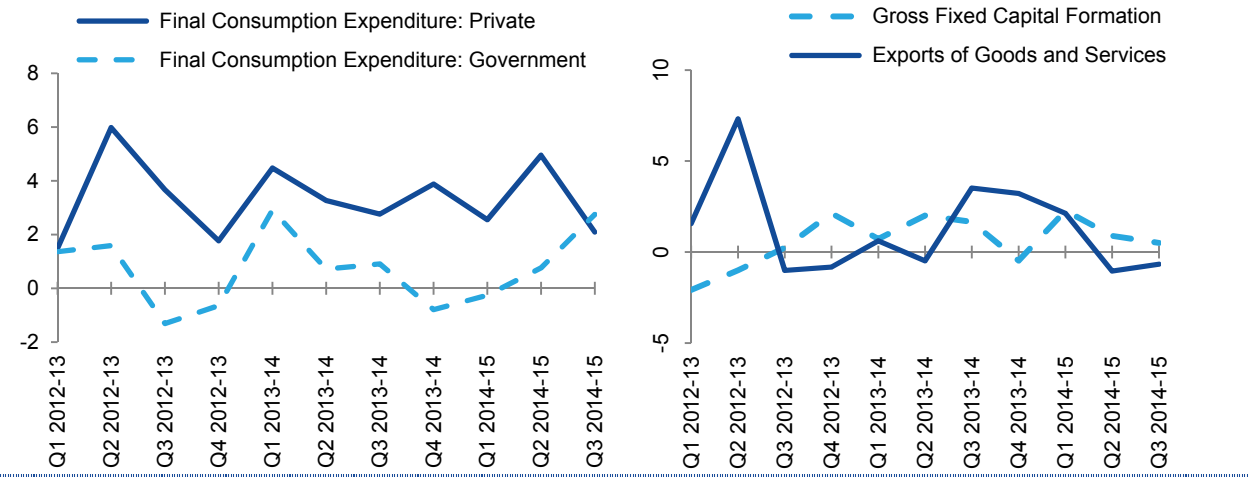
Agriculture output growth continued to decelerate in 2014-15

Agriculture output growth continued to decelerate (growth turned negative in the third quarter, yoy) due to deficient rainfall. Growth in agricultural output decelerated during the first three quarters 2014-15 to 1.4 percent from 3.4 percent last year, due to below-normal rainfall during the monsoon season. Total food-grain production during the kharif (summer) season – which accounts for more than one-third of total agricultural output was 3 percent below the level in previous year. The decline is largely attributed to deficient rainfall (53 percent of the gross cropped is rain-fed) which affected the production of rice, coarse cereals and pulses.

On the expenditure side, consumption growth, at 6.2 percent in the first three quarters of 2014-15, was most robust

Private final consumption expenditure (which accounts for close to 60 percent of total demand for output) grew at average 6.5 percent yoy during the first two quarters of 2014-15, but decelerated to 3.5 percent in the third quarter (Figure 2). This deceleration was in-turn countered by a 32 percent spike in public consumption expenditure in the third quarter. In 2014-15 government consumption was a major contributor to growth. Simultaneously, fixed capital formation (investment), after growing rapidly in the first quarter at 7.7 percent, lost momentum in the next two quarters, growing at an average 2.2 percent. Exports growth has been worryingly negative in the second and third quarters of 2014-15, the growth in three quarters averaging at a low 0.5 percent. Low exports growth was on account of the decline in petroleum exports, and stagnant exports of gems and jewelry, which together account for one third of the export basket; but also due to slow exports growth of other products.

Figure 2: Private and Public Consumption contributed primarily to GDP Growth in 2014-15, while Contribution from Investment and Exports Remained Subdued
(percent contributions, yoy)



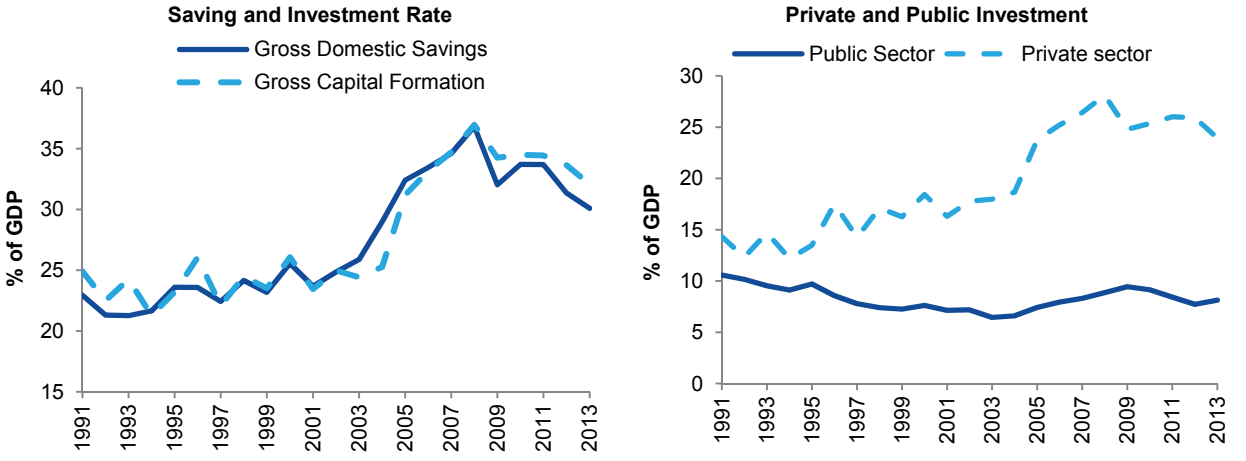
Source: Central Statistical Office, India

2. Private Sector Investment

Investment's contribution to GDP growth was modest in 2014-15

Private investment in particular remained subdued, compared to the other drivers of growth, as well as to its own past performance. The weak investment growth is attributed to a combination of factors, as discussed aptly in the Economic Survey, "weak corporate balance sheets, an impaired banking system, difficulty of exit, the deficiencies of the public private partnership (PPP) model in infrastructure—could hold back private investment going forward".

Figure 3: After Increasing Impressively in the mid-2000s, Savings and Investment Ratios have declined, and Rebound is not yet in Sight (data for fiscal years)



Source: Central Statistical Office, India

Slowdown in investment is evident across all sectors of the economy

As discussed in the Economic Survey, the decline in the rate of investment has extended to all major sectors of the economy--agriculture, manufacturing, construction, other non-industrial sectors, as well as services. For example, in construction activities, the rate of capital formation declined from 6.5 percent in 2011-12 to 5.5 percent in 2013-14; translating in to an annual decline in investment of 11.5 percent in 2012-13; and a further decline of 4.4 percent in 2013-14 (Figure

3). The construction sector has also been affected by a decline in the FDI in recent years, annual FDI flows declined by 8 percent in 2013-14 and by 2 percent in April-November 2014-15. Just like the other sectors, the investment outlook in the construction sector, has been dented by issues related to the prevailing PPP models, and stretched balance sheets in the banking sector. The current situation is considered precarious in which some developers find it challenging to even meet their working capital needs.[4]

A large number of private sector projects are currently stalled, with investment worth 7 percent of GDP locked up in these projects

Private sector has a high rate of stalling, with about 16 percent of its projects under implementation currently held up. While a large number of projects are held up in the infrastructure sector, particularly in electricity, projects are also held up in other sectors, including manufacturing. The main reasons for stalled projects are considered to be poor market conditions, lack of promoter interest and inability to acquire timely regulatory clearances for private sector projects; government projects seem to be held up due to issues related to land acquisition, lack of funds and lack of timely regulatory clearances.

The government has set up a Project Monitoring Group to track stalled projects and to remove their implementation bottlenecks

The government has set up a Project Monitoring Group (PMG) to track stalled projects and to remove their implementation bottlenecks. Project involving investments of INR 10 billion or more, or any project in sectors such as infrastructure, manufacturing, power, etc. can be referred to the Group for resolution. The PMG has already been successful in resolving more than 200 of the projects referred to it, worth nearly 30 percent of the value of all projects (Table 1).

The government has announced several additional measures to ease regulatory constraints on private investment and to step up public investment in order to catalyze private investment

Authorities proposed to introduce a Public Contracts (Resolution of Disputes) Bill to streamline the institutional arrangements for the resolution of disputes in public contracts; as well as to set up exclusive commercial divisions in various courts for faster resolution of commercial disputes. The government has sought to increase investment in infrastructure by the public sector, specifically in roads and railways, in order to "crowd in" private investment. The allocation in the budget for infrastructure investment by the public sector is estimated at INR 700 billion. Besides, to encourage greater private sector financing in infrastructure, the budget has announced tax free bonds to raise funds for railways, roads and irrigation projects; plans to revive the PPP model to encourage greater private sector participation in large infrastructure projects; and corporatization of public sector ports and their conversion into companies under the Company's Act, to attract investments therein.

[4] Recently the norms related to minimum land area, capitalization, and repatriation of funds for FDI in construction development projects have been liberalized (Economic Survey, 2015).

Table 1: Projects referred to the Project Monitoring Group (PMG) and Resolved
(Amount in INR 10 million)

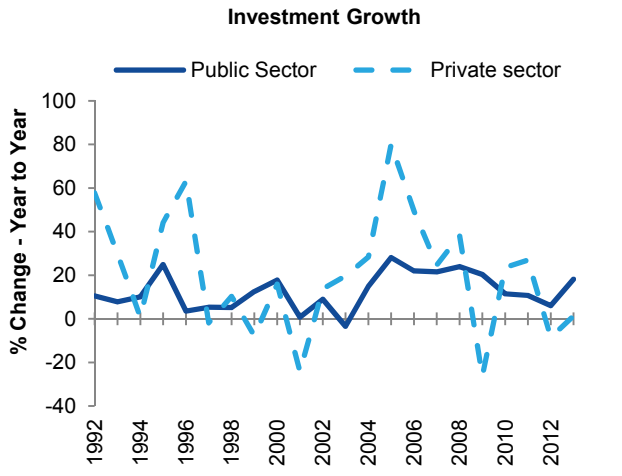
	Number of Projects Referred	Total Value of the Projects Referred	Number of Projects Resolved	Total Value of the Projects Resolved
Power	200	1,107,138	103	460,140
Coal	77	127,856	30	12,674
Steel	51	509,116	7	40,296
Petroleum and Natural gas	48	370,709	19	44,425
Roadways	41	59,070	15	20,410
Railways	26	51,994	10	26,045
Commerce and industry-DIPP	20	37,315	4	14,200
Shipping	19	38,787	8	1,008
Commerce and industry-Commerce	9	54,285	2	10,000
Mines	8	51,208	4	24,205
Chemical and Fertilizers	3	19,178	0	0
Civil Aviation	2	24,000	2	24,000
Textiles	1	1285	1	1,285
Petrochemicals	1	9000	0	0
Total of above	**506**	**2,460,941**	**205**	**688,687**

Source: Project Monitoring Group, Cabinet Secretariat, Government of India

The correlation between public investment on private investment has not been very strong in the past, indicating that the crowding in effect may not be very strong going forward

Looking at past two decades of data on private investment and public investment, two observations stand out. First, the size of private investment is much larger compared to public investment; second, private and public investment growth seem to have their own trajectories quite unrelated to each other (Figure 4). This "disconnect" is borne out in a simple analysis of the correlates of the private investment growth in Table 2 below. Regressing annual growth in private investment on one or two lags of the growth of public investment, or GDP growth; estimates show that the private investment has not correlated strongly with public investment; even though its correlation with GDP growth is high. One possible interpretation of these results is that private investment has been more responsive to market conditions, while the "crowding in" impact from public investment has been weak.

Figure 4: The Rate of Growth of Private and Public investment seem Weakly Correlated, implying the "Crowding in" is perhaps not very Strong



Source: Central Statistical Office, India

Table 2: Correlates of Growth in Private Investment
(Dependent variable: percent growth in private investment)

Independent Variables	(1)	(2)	(3)	(4)
Growth in Public Investment, lag1	0.26	0.44		
	[0.63]	[1.03]		
Growth in Public Investment, lag2		-0.51		
		[1.16]		
Growth in GDP, lag1			3.16***	3.51***
			[3.32]	[3.51]
Growth in GDP, lag2				-1.49
				[1.56]
Constant	9.15**	11.11**	-9.98	-2.47
	[2.29]	[2.42]	[1.36]	[0.32]
Observations	22	22	22	22
R-squared	0.02	0.08	0.25	0.30
Adj. R-squared	-0.03	-0.02	0.21	0.23

Note: Data are annual for 1993-2014. Regressions are estimated by Ordinary Least Squares.
Source: Central Statistical Office and World Bank Staff calculations

With the fiscal space running thin, there may be limited room for public investment to help bridge India's infrastructure deficit

Unlocking private investment, especially in manufacturing, would be critical to support higher growth and exports buoyancy. With a stubbornly low tax-to-GDP ratio, alternative channels of long term investment need to be explored while reviving the PPP model of financing to meet India's yawning infrastructure gap. Simultaneous efforts to increase the tax-to-GDP ratios, through the timely implementation of the GST, as well as complimentary measures to improve tax administration and compliance would generate additional fiscal space in the years ahead.

Debt overhang in corporate balance sheets, extending to the public sector banks, as well as to the public sector, further weighs on the outlook for investment

The outlook for new investments continues to be dented by the debt overhang in the corporate balance sheets, which has extended to the Public Sector Banks (PSB). The banks' balance sheets are currently marred by high Non-Performing Loans, low profitability, and subdued credit growth, and may not be able to support higher demand for credit if the investment cycle were to turn around. While some measures have been announced to strengthen the balance sheets of the PSBs and to improve their operational efficiency, more decisive measures would be needed given the underlying magnitude of the recapitalization requirement and other medium term ownership related issues.

3. Financial Sector Issues

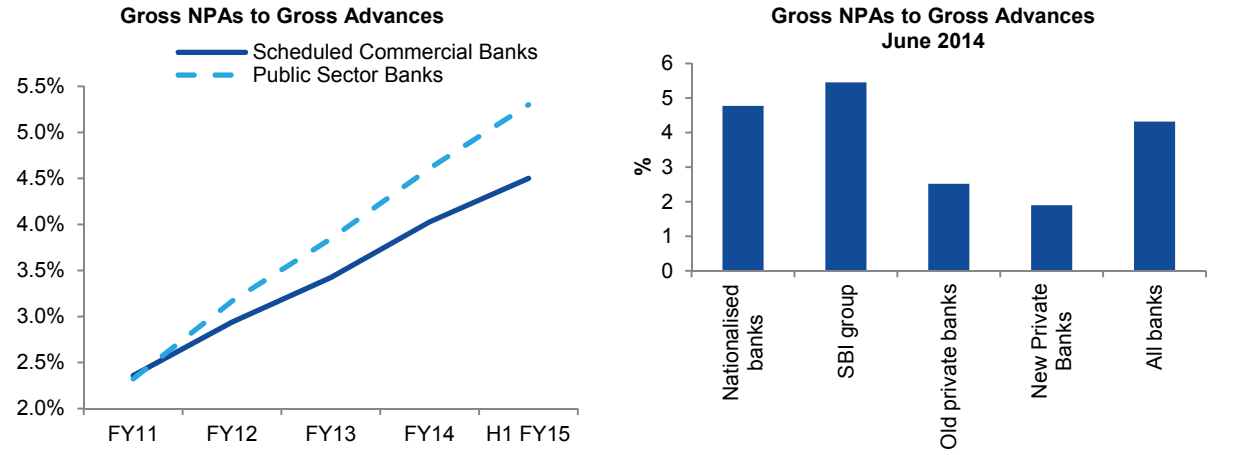
The outlook for Indian banks continues to be weighed down by high non-performing loans

Gross Non-Performing Advances (GNPA) of Scheduled Commercial Banks (SCBs), as a percentage of total gross advances, increased to 4.5 percent in September 2014 from 4.1 per cent in March 2014, and 3.2 percent in March 2013 (Figure 5). [5] Simultaneously, stressed advances increased to 10.7 per cent of the total advances in September 2014 from 10.0 per cent in March 2014. Public Sector Banks (PSBs) continue to record higher level of Non-Performing Loans as well as stressed assets (at 12.9 percent of their total advances as compared to 10.7 percent for all commercial banks). Within the PSBs, the SBI and affiliated banks bear the highest

[5] Gross non-performing advances are the loan assets that are classified as non-performing as per the RBI's guidelines; GNPAs are gross of provisions regarding NPAs.

ratio of non-performing assets, possibly due to their higher exposure to large infrastructure loans (infrastructure, iron and steel, aviation, and mining together accounted for over half of total stressed assets as of December 2014). Amidst deteriorated balance sheets, provision coverage ratio declined from 71.4 percent to 53.7 percent from March 2014 to September 2014, below the RBI's benchmark of 75 percent.

Figure 5: Gross Non Performing Loans as a percentage of Gross Advances increased; Non Performing Loans are higher in the Public Sector Banks

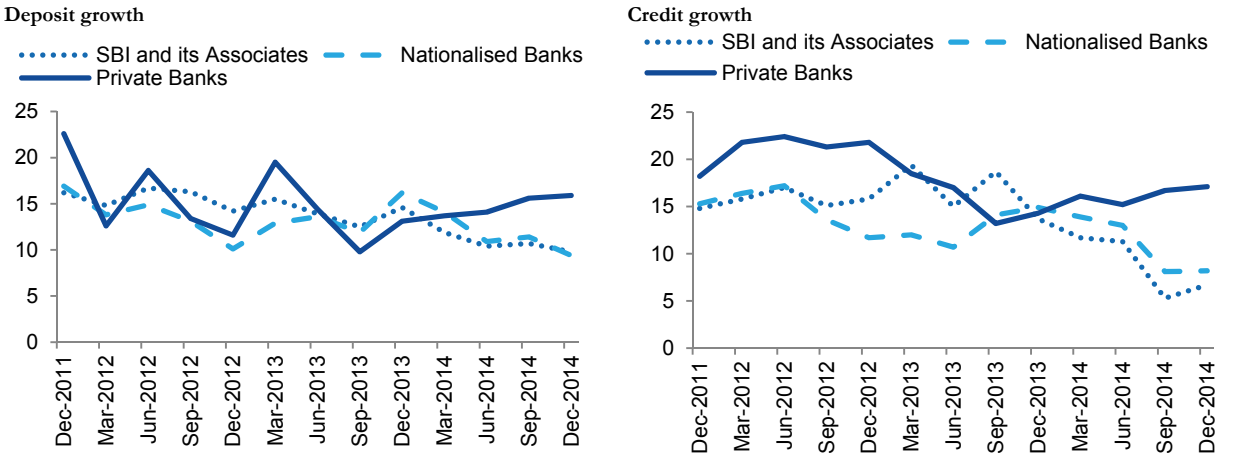


Source: Reserve Bank of India

Credit growth remained sluggish, reflecting risk aversion and weak balance sheets of banks

Credit growth at 10.1 percent, yoy, in December 2014 remained lower than the 14.2 percent recorded in the previous year (Figure 6). Though a slight improvement over 9.5 percent growth yoy in September 2014, it is not certain whether the increase would prove to be durable. The slowdown is largely attributed to slow credit growth in the PSBs, which focused more on recovery given their weak balance sheets. Deposits growth declined as well, to 10.9 percent in December 2014 from 12.3 per cent as of September 2014 and 15.4 percent in December 2013. Banks' profitability remains under pressure due to higher delinquency requirements and slowdown of credit growth.

Figure 6: Deposit and Credit Growth remains Subdued across Banks, particularly in the Public Sector Banks



Source: Reserve Bank of India

The Government considered ways to raise additional capital for banks facing asset quality issues amidst sizable capital needs and high financing costs

With the high non-performing loan ratios, and the imperative to follow Basel III norms and bolster capital to sustain credit growth at levels that support the economy adequately, India's public sector banks are likely to face a shortfall of capital.[6] The government has announced some measures to augment their capitalization. The banks have been allowed to reduce government's share in equity to 52 percent in a phased manner. However, given their current valuations, short term divestment is unlikely to takeoff in near term, nor fiscally optimal without efforts to bolster valuations. The government has announced a new criterion for determining banks' eligibility for capital infusion by the government. The new criterion, announced in February 2015, takes into consideration the past performance of the bank and requires that its Return on Assets must exceed the average of all PSBs for the past three years, and its Return on Equity must be higher than the average, for the past one year. As per this criterion, only nine PSBs were found eligible to receive equity from the government; and would receive altogether INR 69.9 billion in 2015-16.[7]

Box 1: Recent announcements pertaining to the financial sector

Recognizing the need to strengthen the balance sheets of public sector banks and to improve their operational efficiency so that they could compete with private banks and play an active role in supporting economic growth, the government held a two-day retreat with the top management of banks and financial institutions in January, 2015. Discussions focused on enhancing the functional autonomy of the PSBs, and on improving their governance structure (some of the discussion modeled on the recommendation of the P J Nayak Committee report). Several measures were announced during the year to strengthen the financial sector, such as:

- Set up an autonomous Bank Board Bureau to improve the governance of PSBs. The Bureau would search and select the banks' heads and assist them in developing differentiated strategies and capital raising plans.
- Proposal for a Micro Units Development and Refinance Agency (MUDRA) Bank through a statutory enactment. The Bank would be responsible for regulating and refinancing all micro-finance institutions which are in the business of lending to micro/small business entities engaged in manufacturing, trading and services activities. It would partner with state and regional level coordinators to provide finance to 'last mile financer' of small/micro business enterprises.
- Set up a task force to establish a sector-neutral Financial Redressal Agency, as per the recommendation of the Financial Sector Legislative Reforms Commission, to address grievances against all financial service providers as a one-stop shop. The agency along with the other ongoing efforts on financial literacy could help in making manufacturers and distributers of financial products more accountable and investors less wary of availing financial services.
- To harmonize the regulatory environment for Non-Banking Financial Corporations (NBFCs) and commercial banks, the RBI announced tighter norms for NBFCs, which included an increase in the minimum capital requirement, tighter rules on deposits and bad loans and stricter corporate governance practices. In addition, the budget 2015-16 proposed that the NBFCs with a size of INR 5 billion or more would be considered as 'Financial Institutions' in matters related to recovery, by allowing them to access recovery provisions of the SARFAESI Act .
- PSBs have been allowed to reduce government's share in equity to 52 percent in a phased manner. In addition, a new criterion has been promulgated for determining their eligibility for capital infusion by the government. The new criterion, announced in February 2015, takes into consideration the past performance of the banks and requires that its return on assets must exceed the average for all PSBs for the past three years, and that its return on

[6] World Bank estimates indicate that US$36 billion Tier I capital would be needed over the next five years to sustain capital adequacy of PSBs.

[7] ICRA "Indian Banking Sector", February 2015, indicates that the ineligible banks would need about half the PSBs' total requirement during FY2015-FY2019 of INR 2.6 trillion in equity and around 40 percent of the INR 1.4 trillion in Additional Tier I capital to meet their growth objectives and to comply with Basel III norms.

equity must be higher than the average for the past one year.[8] As per this criterion, only 9 PSBs were found eligible to receive equity from the government; and would receive altogether INR 69.9 billion in the upcoming fiscal year.[9]

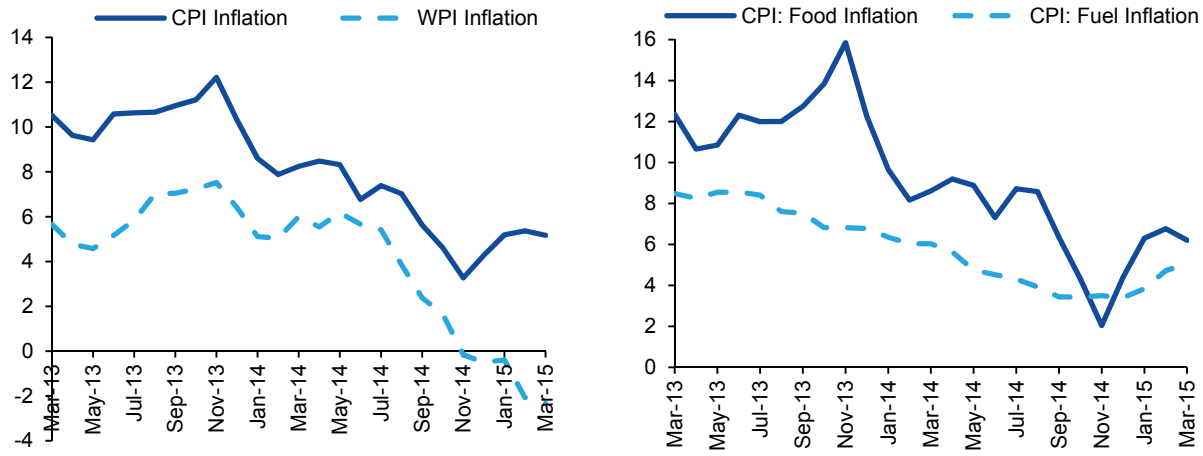
- The RBI awarded two new bank licenses; and laid the norms for small finance and payment banks.

4. Inflation

Average CPI inflation declined by 4 percentage points in 2014-15– falling from an average of 10 percent in 2013-14 to 6 percent in 2014-15

After averaging at 7.3 percent in the first half of 2014-15, inflation declined sharply to 4 percent in the third quarter before stabilizing at 5.2 percent, yoy, in the last quarter of 2014-15. The moderation in inflation was broad based and reflected both in the WPI and CPI series; as well as separately in core inflation and in food and fuel inflation—the two components with a cumulative weight exceeding 50 percent in the CPI index (Figure 7). To the extent that it is reflected in a moderation of rural wages, as well as in a decline in inflationary expectations, the current decline in inflation seems well anchored. Among different components that contributed to the decline in inflation, the most prominent was the sharp decline in the food and beverages category, followed by the miscellaneous category (consisting of health, education, recreation and other services, and household goods) (Figure 8).

Figure 7: Moderation in Inflation (yoy) was broad based, seen in CPI, WPI; Food, and Fuel Inflation
(percent change yoy)

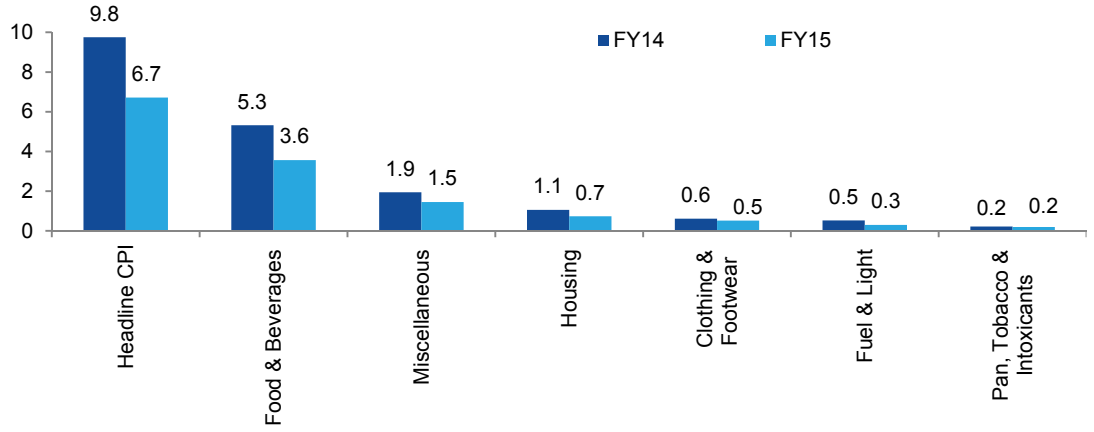


Source: Ministry of Statistics and Programme Implementation, India.

[8] ICRA "Indian Banking Sector", February 2015, indicates that the ineligible banks would need about half the PSBs' total requirement during FY2015-FY2019 of INR 2.6 trillion in equity and around 40 percent of the INR 1.4 trillion in Additional Tier I capital to meet their growth objectives and to comply with Basel III norms.

9 World Bank estimates indicate that US$36 billion Tier I capital would be needed over the next five years to sustain capital adequacy of PSBs.

Figure 8: Decline in Food and Beverages Inflation, primarily Contributed to the decline in Inflation in 2014-15
(yoy CPI Inflation in April-January of 2013-14 and April-January 2014-15)

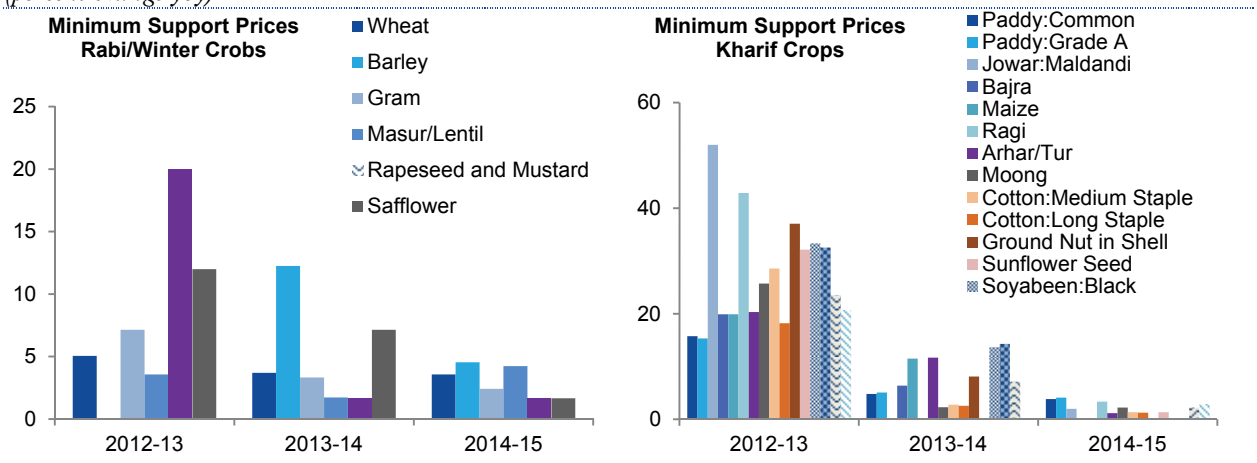


Source: Ministry of Statistics and Programme Implementation, India.

Both domestic and global factors contributed to moderating inflation in the past few months

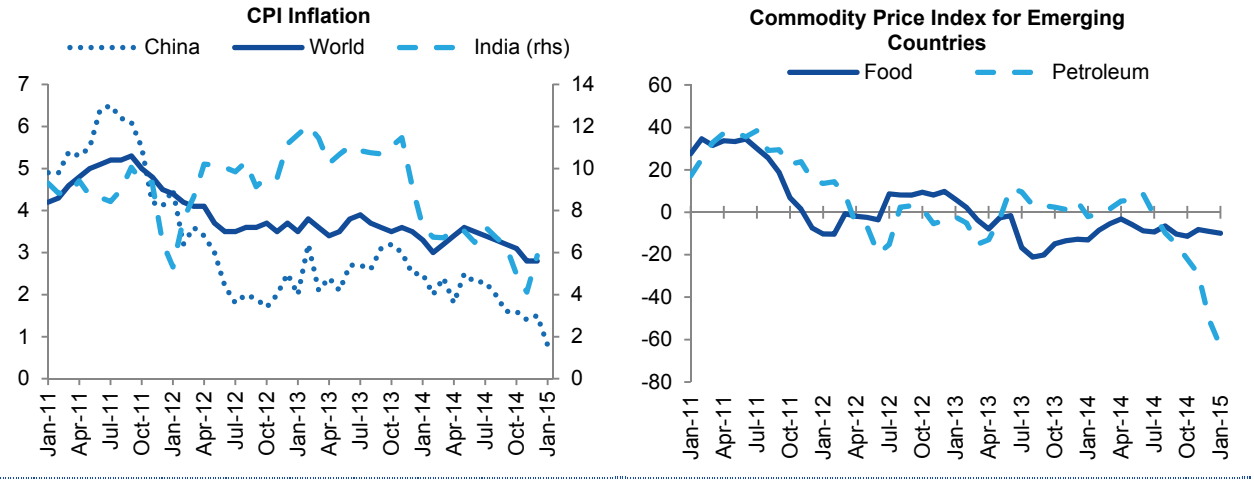
While the decline in inflation in India is consistent with the decline in the international prices of oil, food, and other commodities, domestic policy factors (Figure 9 and Figure 10)- such as restraint on food procurement prices (the government mandated minimum support prices of Rabi (winter) and Kharif (summer) crops increased marginally in 2014-15); releasing public food grain stocks in the market; restrained monetary policy; and a stable or slight appreciation in exchange rate contributed as well (Figure 11).

Figure 9: Several Domestic and Global Factors Contributed to Moderating Inflation in India
(percent change yoy)



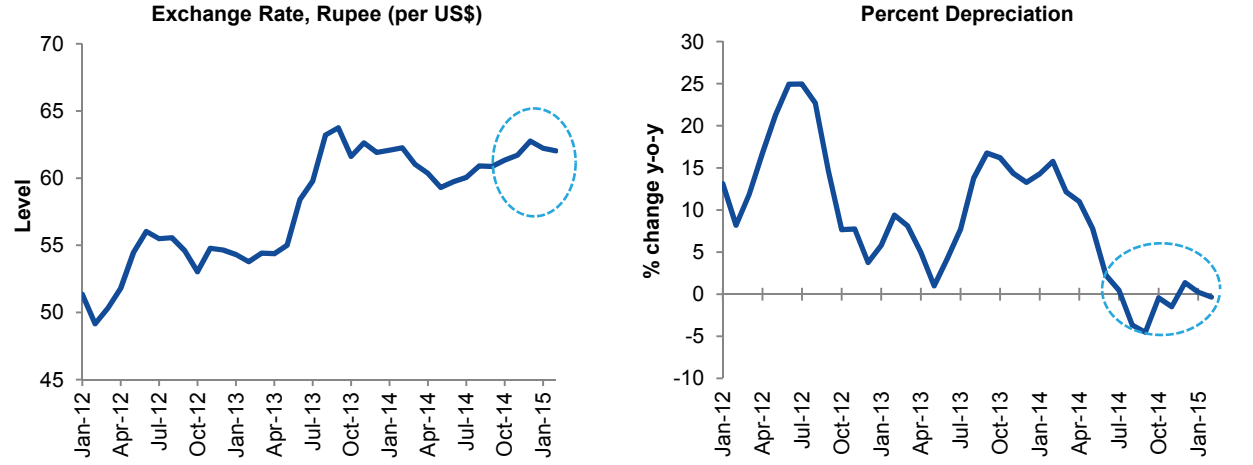
Source: Ministry of Agriculture, India

Figure 10: Inflation has been simultaneously declining globally, including in major emerging economies; partly driven by the global decline in the oil and commodity prices
(percent change yoy)



Source: IFS

Figure 11: Exchange rate depreciation was much lower in 2014-15, (some appreciation was seen in the past few months) further abating inflationary pressures



Source: Reserve Bank of India.

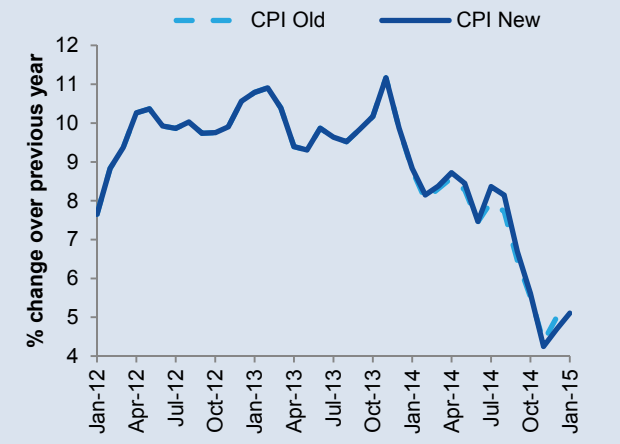
The outlook for inflation remains benign going forward

The favorable outlook is based on expectations that global oil and food prices would remain low -- international agricultural prices, which fell 3.4 percent in 2014, are expected to decline by another 5 percent in 2015, while oil prices are expected to remain relatively low; the government broadly adhering to its fiscal stance; and the recent move to the flexible inflation framework anchoring inflationary expectations. Some upside risks to food prices may arise in the event of adverse weather or unanticipated large increases in the Minimum Support Price of food grains, and because full impact of excess rains in recent months may not have been felt.

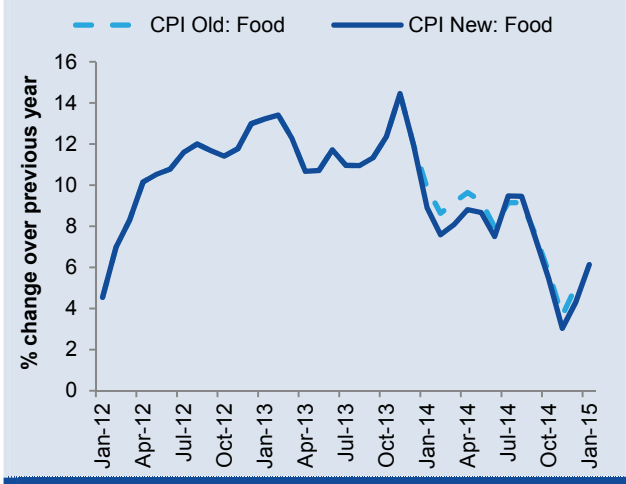
Box 2: Revision in the CPI series

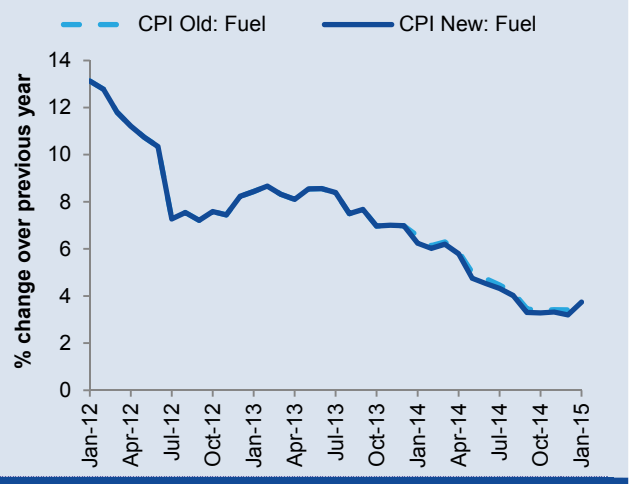
Consumer Price Index was revised in February 2014 by the Central Statistical Office to change the base year from 2010 to 2012. The exercise included some methodological changes as well—converging more closely with the international practices and classification; using a shorter reference period for food items and a longer reference period for the items that are consumed at lower frequency; and using a wider set of prices to calculate PDS prices. In addition, it revised the composition of the price baskets for rural and urban areas, increased the number of items in each basket, and reallocated the weights reflecting changing consumption patterns. Accordingly, the weight on food, and fuel and light was lowered while that on clothing, footwear, and miscellaneous was increased. Unlike the revision in the GDP series, where the growth rates computed by using the old and new series deviated significantly, the revised CPI series tracked the old series quite closely. A comparison of the old and new series, Figure 12, shows roughly similar patterns in overall inflation as well as separately in the various components of the price basket, including food and fuel inflation.

Figure 12: Inflation calculated using old and revised series of CPI Track each other quite closely



Source: Central Statistical Office, India





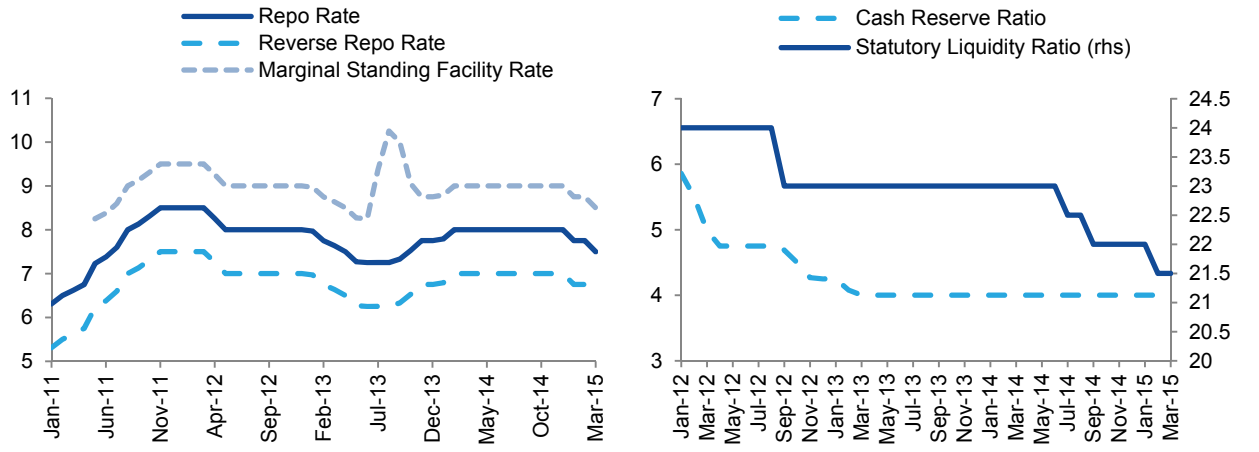
5. Monetary Policy

Policy rates were lowered in the last quarter of 2014-15

The RBI lowered the policy repo rate twice, on January 15, 2015 and March 4, 2015, by 25 basis points each time, to 7.5 percent in March, 2015 (Figure 13). Interestingly, on each occasion, the interest rate action was announced outside the regular monetary policy cycle, and hence contained a more than the usual element of "surprise", as perceived by the markets. The RBI attributed the latest cut in the rates to inflation falling below the 8 percent target set for January 2015; the broad expectation that inflation would stay below 6 percent until January 2016; the government managing to stay within the budgeted fiscal deficit target in the current fiscal year, and its plan to consolidate the deficit in years ahead; and the proposed improvement in the quality of expenditure in the budget for next year. While the RBI did not change its policy stance during the first three quarters of the fiscal year, it announced certain other accommodative measures. The Statutory Liquidity Ratio (SLR) was lowered thrice, on June 14, 2014, August 5, 2014 and February 3, 2015,

by 0.50 percent each time. The RBI communicated frequently with the markets and provided forward guidance through its published bi-monthly policy reviews and regular interactions with the media and experts.

Figure 13: Monetary Policy was Accommodative in the Last Quarter of Fiscal Year, 2014-15
(percent)



Source: Reserve Bank of India

The government and the RBI signed the flexible inflation targeting framework for monetary policy which is likely to enhance the credibility of monetary policy

As per the new framework, signed on February 20, 2015, based on the recommendation of the Urjit Patel Committee Report (submitted in January 2014), it was agreed that the RBI would adhere to a "flexible inflation target", and to a Target of CPI inflation below 6.0 percent by January 2016 and a Target of 4 percent, within a band of (+/-) 2 percent around it, by end-2016-17. The objective of monetary policy would be to "primarily maintain price stability while keeping in mind the objective of growth". The RBI would be required to bring out a document every six months explaining the sources of inflation and providing inflation forecast for the following 6-18 months. If inflation exceeds more than 6 percent for three straight quarters in 2015-16, or falls below 2 percent for three straight quarters in 2016-17, the RBI would have to explain the reasons for not meeting the target and lay out the remedial actions.[10]

One challenge that the RBI continues to face is the weak transmission of monetary policy

As has been acknowledged by the RBI on numerous occasions, monetary policy actions do not seem to filter down adequately, or fast enough, to the interest rates on bank deposits and bank credit. The RBI Governor has also talked about an asymmetry in the behavior of banks -- while they have been relatively more responsive in raising the interest rates after policy tightening, they lower rates more slowly or inadequately in response to an easing. This problem is not unique to India though. In developing countries in general, the transmission mechanism is considered weak due to factors such as the prevalence of economic activities in the informal sector, and in particular due to informal financing. Additionally, in India PSBs are believed to propagate the monetary policy less efficiently than private banks.[11] The transmission mechanism could get strengthened in the period ahead

[10] According to the Inflation Expectations Survey of Households: December 2014, published by the Reserve Bank of India, fewer households expect higher inflation during the next three months, than in the past.

[11] As shown in Gupta, Kochhar and Panth (2015), Bank Ownership and the Effects of Financial Liberalization: Evidence from India, forthcoming Indian Growth and Development Review.

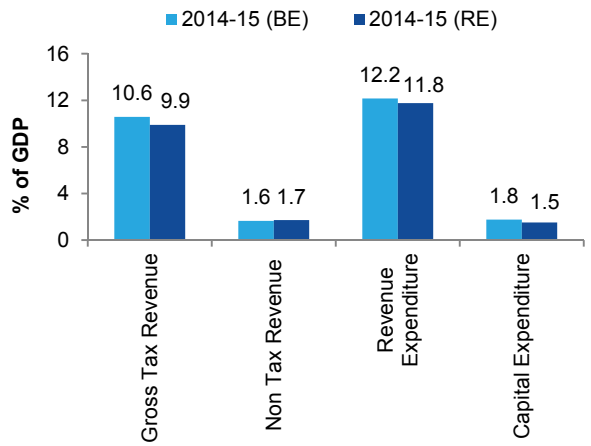
with the current drive on financial inclusion that has been able to bring a previously unbanked population within the ambit of the formal financial sector as well as when the PSBs gain more operational autonomy, are more professionally managed, or when ownership issues are addressed, as is being currently proposed by the government.

6. Fiscal Developments and Union Budget

The fiscal deficit target of 4.1 percent of GDP in 2014-15 is expected to be met despite weak revenue outcomes, primarily through expenditure compression

Fiscal deficit target of 4.1 percent of GDP will be achieved even as revenue collection remained weak, by compressing both current and capital expenditure. Capital expenditure, budgeted at a low 1.8 percent of GDP, achieved an even lower realization of 1.5 percent of GDP in the revised estimates; while the current (revenue) expenditure at 11.8 percent of GDP was also lower than the budgeted 12.2 percent of GDP (Figure 14).

Figure 14: Revised Estimates for Tax Revenue in 2014-15 are lower than Budgeted, necessitating Expenditure Compression to meet the Fiscal Deficit Target



Source: Ministry of Finance, India

Revenue collection was weak in 2014-15 as indirect tax collection, particularly service tax, and disinvestment receipts were lower than budgeted

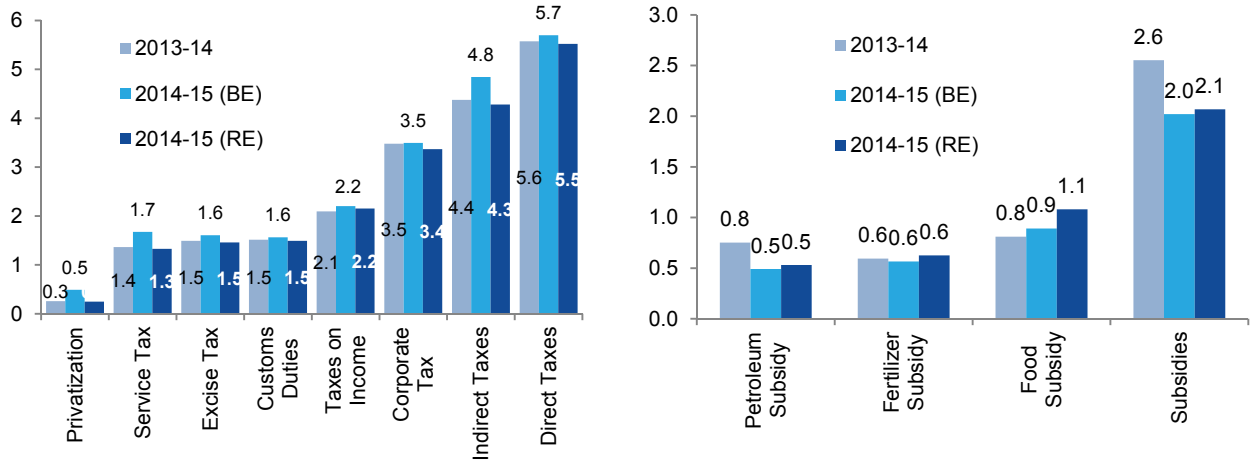
While almost all tax collection targets slipped, the lower outturn was predominantly due to the slippage in Service Tax collection that underperformed at 1.3 percent of GDP, 0.4 percent of GDP lower than the budgeted 1.7 percent. Since 2000-01, the share of Service Tax in total indirect taxes and as a share of GDP has been on a steady rise. The government, in an attempt to widen the tax base and improve compliance introduced a concept of a Negative List of Services (list of services exempt from Service Tax) since July, 2012, a list that can only be amended following parliamentary approval. The outturn of Service Tax in 2013-14 was higher than the norm, which could have been driven by a one-time government scheme that allowed defaulters to pay their unpaid service taxes in the last 5 years without incurring any additional interest, penalty or legal proceedings, by December, 2013, supported by a strong public awareness campaign to pay all Service Tax dues. Disinvestment receipts were lower at 0.2 percent of GDP than the budgeted 0.5 percent of GDP, because the planned disinvestment in CPSEs and the government stake in non-government companies did not materialize.

Subsidy bill was higher than budgeted in 2014-15 because of higher food subsidies

The total subsidy expenditure at 2.1 percent of GDP during fiscal year 2014-15 was marginally higher than the budgeted 2.0 percent of GDP (Figure 15). Declining global crude prices and a phased increase in retail diesel prices allowed for a complete deregulation of diesel prices in October, 2014, resulted in a significant reduction in petroleum subsidies from the 2013-14 outturn of 0.8 percent of GDP to 0.5 percent in 2014-15. Food subsidy expenditure during the same period

increased from 0.8 percent of GDP to 1.1 percent of GDP, offsetting the decline in petroleum subsidies[12].

Figure 15: While Revenue outturns are expected to be lower than budgeted in 2014-15, Subsidies overshot marginally
(percent of GDP)

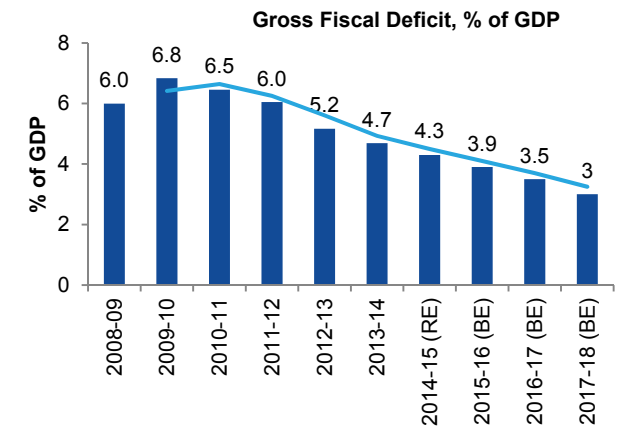


Source: Ministry of Finance, India

Budget for 2015-16 envisages a modest fiscal consolidation, with deficit at 3.9 percent of GDP

The government proposed to slow the pace of fiscal consolidation, and consolidate deficit to 3 percent of GDP in next three years, instead of two as was proposed in the previous budget. The glide path of deficit is set to be at 3.9 percent, 3.5 percent and 3.0 percent respectively in 2015-16, 2016-17 and 2017-18. The new glide path was chosen to open up fiscal space for 'funding infrastructure investment".[13]

Figure 16: Fiscal Deficit Outturns and the Glide Path of Deficit in the Years Ahead



Source: Ministry of Finance, India

The budget proposes to devolve a larger share of tax revenue to the states; and to compress revenue

Following the recommendations of the Fourteenth Finance Commission, share of the States in divisible taxes is budgeted to increase from 32 percent to 42 percent of the gross tax revenue in nominal terms – an increase from 2.7 percent of GDP in revised estimate for 2014-15 to 3.7 percent of GDP in 2015-16 (see Box 3). Consequently, the net tax revenue retained by the Central government would

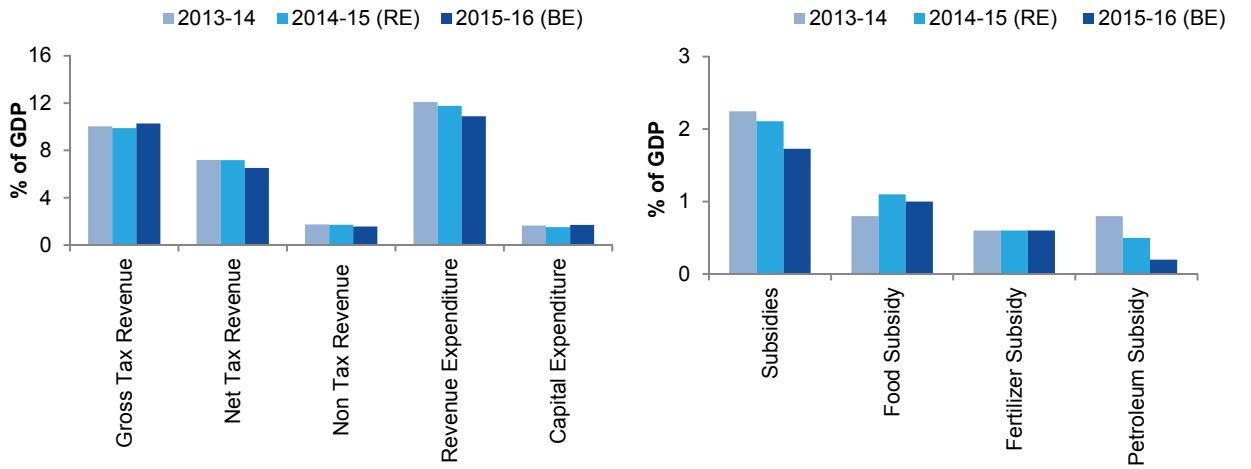
[12] Petroleum subsidies amounting to INR 450 billion were rolled over from 2012-13 to 2013-14. After absorbing INR100 million in 2013-14, the balance INR 350 billion (0.3 percent of GDP) was further rolled over to 2014-15. This practice of rolling over has no precedence prior to 2012-13 and has not been carried out in 2015-16 budget. If the rolled over amount is taken into account, the reduction in oil subsidy burden in 2014-15 effectively works out to be even sharper, from 1.1 percent in 2013-14 to 0.5 percent of GDP in 2014-15.

[13] Budget speech, Union Budget 2015-16.

expenditure.

decline to 6.5 percent of GDP. The current expenditure compression is projected in view of the lower retained tax, even as capital spending is restored to the level seen in 2013-14, at 1.7 percent of GDP. Reduction in fuel subsidy is expected to contribute to the savings on current expenditure. While the budget allocates a larger share of the tax revenue to the States, it also proposes to lower the share of the Center in the Centrally Sponsored Schemes, thus granting more discretion to the States in spending the larger tax receipts. Our calculations show that the net transfer of resources to the states, taking into account lower devolution of other grants and loans turns out to be of the order of 0.5 percent of GDP.[14]

Figure 17: Center to devolve a Larger Share to the States; Lower Current Expenditure, including Fuel Subsidies, while restoring Capital Expenditure



Source: Ministry of Finance, India

Table 3: Central Assistance to State Plans has been restructured to partially compensate for the increased tax devolution to the States

(In billions of INR, percent of GDP)

	2014-15 (RE)	2015-16 (BE)	2014-15 (RE)	2015-16 (BE)
Tax devolution	3378.08	5239.58	2.7	3.7
Total Grants and Loans	3551.93	3282.77	2.8	2.3
Central Assistance to State Plans	2702.69	1957.78	2.1	1.4
Non Plan Grants and Loans	803.38	1086.30	0.6	0.8
Centre/centrally sponsored schemes	45.86	238.69	0.0	0.2
Total Transfer to States and UTs	6930.01	8522.35	5.5	6.0

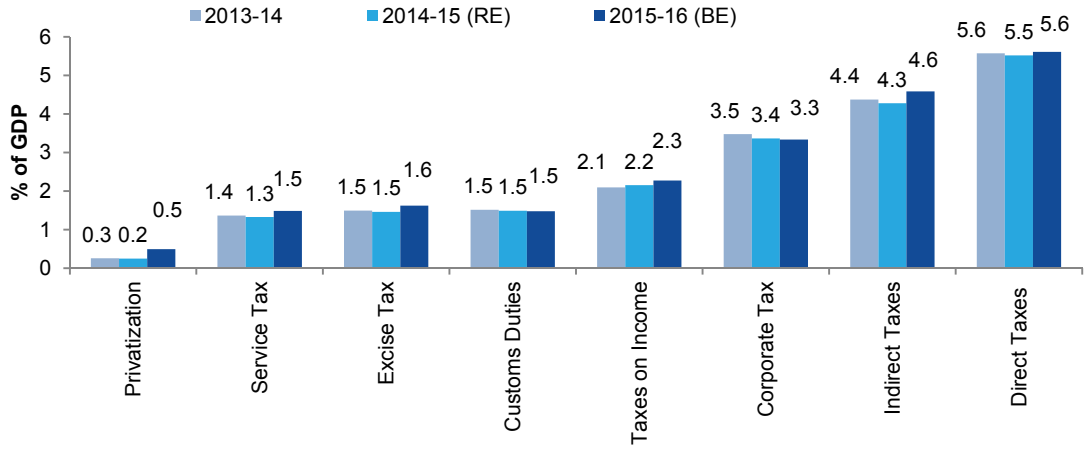
Source: Union Budget 2015-16

Meeting fiscal targets is conditional on realization of tax buoyancy, and disinvestment receipts

The gross tax revenue in 2015-16 is expected to increase to 10.3 percent of GDP, from 9.9 percent of GDP in 2014-15 (RE), and 10 percent of GDP in 2013-14 (Figure 18). Some extra tax buoyancy is built in these estimates compared to the last year. At a disaggregated level, tax buoyancy is particularly assumed in the collection of indirect taxes.

[14] The preliminary estimates calculated by Dr. Rathin Roy of NIPFP (Business Standard, March 1, 2015) show that the center's contributions to flagship schemes, and central assistance for state plans has declined; and the net transfer of resources to the states would be of the order of 0.3 percent of GDP.

Figure 18: Revenue Projections for 2015-16 seem optimistic compared to the past Two Years

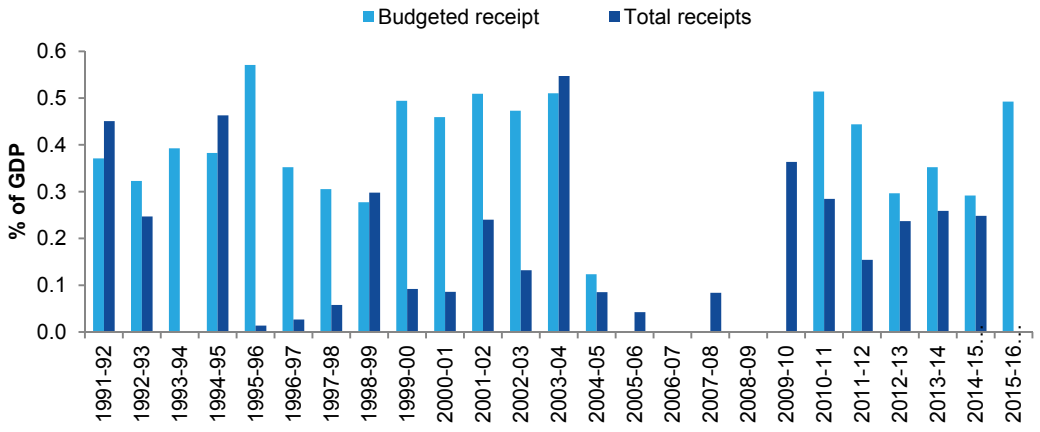


Source: Ministry of Finance, India

In the past, government has often under realized the proceeds from disinvestment

Budgeted disinvestment receipts (at 0.5 percent of GDP) in 2015-16 may turn out to be optimistic. Even though thrice in the past the privatization receipts have been about 0.5 percent of GDP (in FY1992, FY1995, and FY2004), the average in other years has been lower—the average annual receipts during 2010-2014 were 0.2 percent of GDP (Figure 19).[15] Whether the actual fiscal outcomes would be close to the budgeted would depend crucially on oil prices staying low and the government's ability to keep subsides under check, while maintaining the elevated excise rates on petroleum products (see Special Issues I, below).

Figure 19: Disinvestment Receipts have often been less than Budgeted in the Past



Source: Ministry of Finance, India

[15] Planned disinvestment budgeted in 2015-16 would be channelized into a National Investment Fund (NIF) to be used to recapitalize Public Sector Banks and for capital expenditures for the Indian Railways.

Box 3: Recommendation of the Fourteenth Finance Commission

The Finance Commission, constituted every five years by the President of India, makes recommendations on the sharing of tax proceeds between the Center and the State governments from the divisible pool of taxes, i.e. the central taxes excluding surcharges and cesses (the vertical devolution of taxes); as well as on the distribution of tax proceeds across states (called the horizontal devolution). It also reviews the finances of the Center and the States and makes broad recommendations on their fiscal stance and the pace of fiscal correction. The Fourteenth Finance Commission, in a report submitted recently to the President and subsequently tabled in the Budget Session of the parliament, recommended a larger share of the Central tax revenue to be shared with the States than in the past. It recommended that the States' share in net proceeds of the Central tax revenues increase to 42 percent from the 32 percent recommended by the Thirteenth Finance Commission, and similar shares recommended by the previous commissions. It further recommended tax devolution to be the primary source of transfer of resources to the States, reinforcing the ongoing emphasis on greater decentralization.

These recommendations mark a significant departure from the recent trend, wherein the share of Plan grants to the States, relative to the statutory grants, has increased in the past few years; along with the number of Centrally Sponsored Schemes and 'tied' assistance to the States, many of them requiring matching contributions from the states. The trend is believed to have reduced the fiscal space and spending discretion available to the Sates. The recommendations of the Finance Commission derive from two considerations. First, the States' developmental priorities and challenges differ vastly from each other; and second, the States have become fiscally more prudent. They have enacted their own fiscal rules, and broadly adhered to those, and are expected to expend the additional resources in a fiscally prudent manner and as per their own developmental imperatives.

Some of the other recommendations of the Finance Commission are the following.

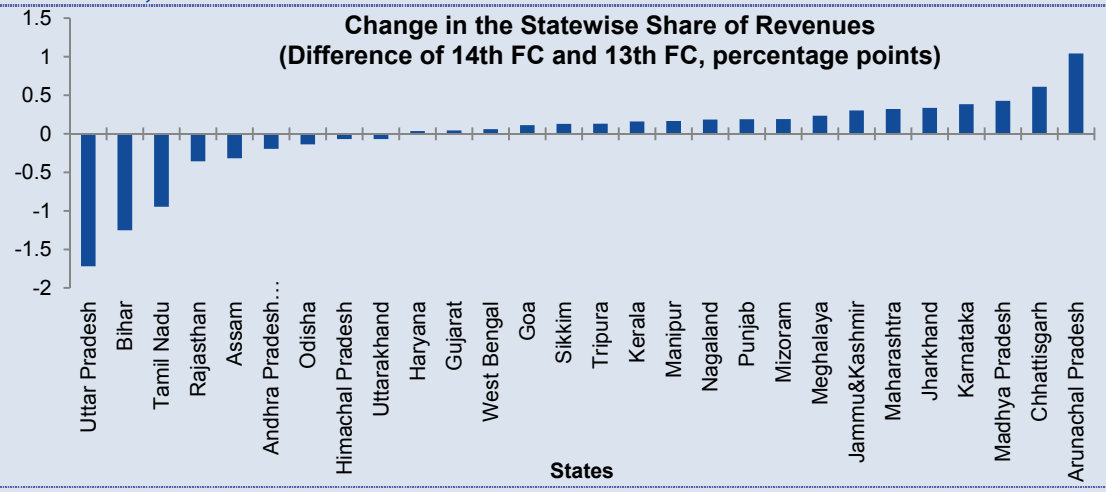
Horizontal Devolution: On the allocation of tax revenue across states, keeping up with the past recommendations, the Fourteenth Finance Commission allocated a large weight of 50 percent, to the income level, specifically, the distance from the highest per capita income district (as a measure of fiscal capacity); followed by a weight of 27.5 percent to population (17.5 percent to the level of population in the 1971 census, and a 10 percent weight to population in the 2011 census, thereby accounting for demographic changes); a 15 percent weight to area; and a remaining 7.5 percent weight to the forest cover of the states. In assigning these weights, unlike the past commissions, the Fourteenth Finance Commission did not give any weight to the fiscal outcomes of the states. The reassigning of weights across categories, and the changing economic and demographic status of the states, imply that their share in the Center's divisible taxes has changed since the Thirteenth Finance Commission, as depicted in Figure 20 below.

Table 4: Recommended Criteria for Horizontal Devolution of Tax Revenue among States

	11th FC	12th FC	13th FC	14th FC
Income Distance	62.5	50	47.5	50
Population/ Demographic	10	25	25	17.5 10
Area	7.5	10	10	15
Fiscal performance/ Tax effort/ Fiscal discipline	7.5	7.5	17.5	
Infrastructure	7.5			
Forest Cover				7.5

Source: Reports of the respective Finance Commissions

Figure 20: Change in the Distribution of Tax Revenue across States in the Fourteenth Finance Commission, over the Thirteenth Finance Commission



Source: Economic Survey, India

Fiscal Institutions and Consolidation: The Finance Commission also made recommendations on the medium term fiscal outcomes of the Center and the States, as well as on budgetary institutions. These include:

- Fiscal deficit of the Center should be lowered to 3.6 per cent of GDP in 2015-16, from projected 4.1 per cent in 2014-15; to 3 per cent in the following year; and kept at 3 percent for three more years. It recommended a similar time path of the Center's revenue deficit--to be brought down to 2.9 per cent in 2014-15, 2.56 per cent in 2015-16, and progressively reduced to 0.93 per cent by 2019-20. It recommended that the subsidy bill should be gradually lowered from 1.6 percent of GDP in 2016-17 to 1.0 percent of GDP in 2019-20, by reducing it by 0.20 percent of GDP each year in between. It recommended that the debt stock of the Union Government should decline from 43.6 percent of GDP in 2015-16 to 36.3 percent of GDP in 2019-20; and the fiscal deficit of the States to be anchored to an annual limit of 3 per cent of the Gross State Domestic Product.

- Further, its recommendations included that the Fiscal Responsibility and Budgetary Management (FRBM) Act should be replaced with a Debt Ceiling Fiscal Responsibility Legislation. On the long-term fiscal reform agenda, it favored a rule-based approach for the Center and the States; and that the government should establish an independent fiscal council to undertake ex-ante assessment of the implications of budget proposals and their consistency with the established fiscal policy and rules. It also recommended that the Union Government should consider setting up a Consolidated Sinking Fund to create a cushion to meet repayment obligations in times of fiscal stress and facilitate borrowings in the primary market at reasonable costs.

Goods and Services Tax (GST): The Fourteenth Finance Commission proposed a somewhat more generous compensation formula for the States than is currently being considered—it recommended compensation to the States for five years, instead of three--with 100 percent compensation to be paid in the first three years followed by a compensation of 75 percent in the fourth year and 50 percent in the final year. It recommended the creation of an autonomous and independent GST Compensation Fund through legislative action, thus generating a guaranteed pool of funds to compensate the States for their temporary loss of revenue.

7. Balance of Payments

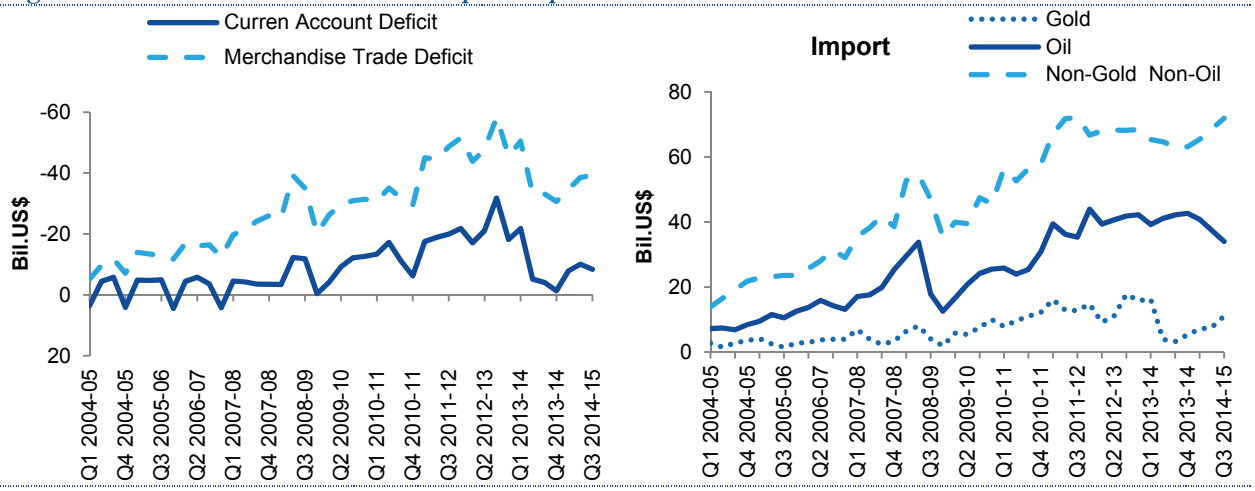
The balance of payment outlook improved during the year, with a decline in the current

Sharp decline in oil prices since June 2014, helped contain the trade deficit to $112 billion (7.4 percent of GDP) in the first three quarters of 2014-15, lower than the $117 billion (8.4 percent of GDP) over the same period in the previous fiscal year (Figure 21). Along with the steady stream of remittances and receipts from service exports, lower trade deficit helped in curtailing the current account deficit to $26

account deficit and a pickup in capital flows

billion (1.7 percent of GDP) in the first three quarters of the fiscal year, compared to $31 billion (2.2 percent of GDP) in the three quarters of 2013-14 – a significant improvement over the previous two years when the current account deficit averaged $83 billion in respective three quarters. Simultaneously, buoyancy in capital inflows, particularly from portfolio investors, was reflected in some exchange rate appreciation and led the RBI to accumulate foreign exchange reserves which increased to $338 billion as of February 27, 2015.

Figure 21: Decline in the Value of Oil Import helped restrain Trade Deficit and the Current Account Deficit



Source: Reserve Bank of India

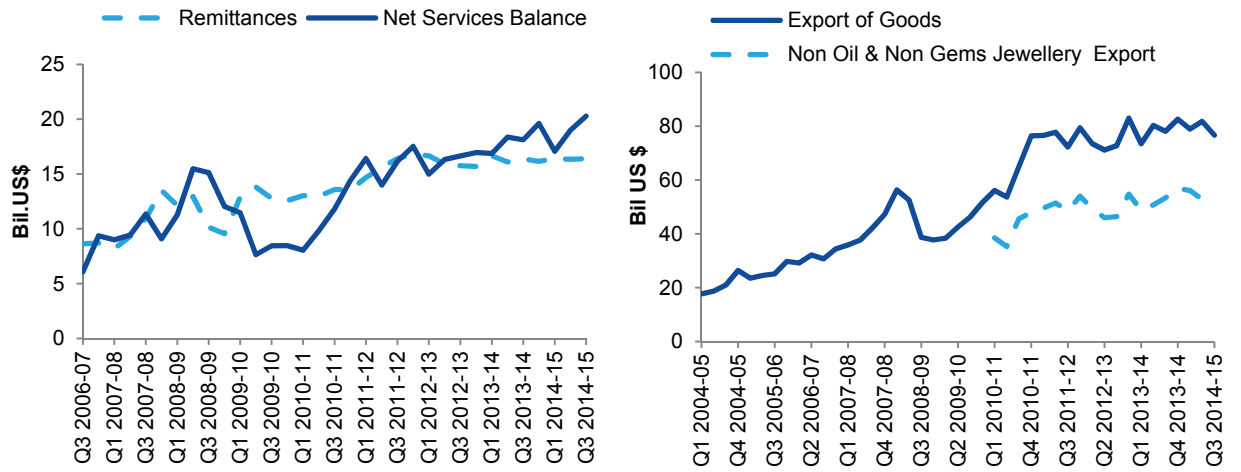
The sharp decline in the price of oil helped reduce merchandise trade deficit, while gold imports were contained

Crude petroleum imports, accounting for more than 30 percent of all merchandise imports in India, meet more than three-fourths of the country's demand for oil. India is also a large exporter of refined petroleum–accounting for nearly 20 percent of total merchandise exports. During 2012-2014 net imports of petroleum average nearly $100 billion a year. As global crude prices declined from June 2014, India's oil import bill also declined. Value of crude oil imports declined by 8 percent yoy during Apr 2014-Jan 2015, and tempered the impact of the increase in the demand for other imported goods – such as consumer durables, capital goods or industrial raw materials, on the current account. India has traditionally also been a large importer of gold. The import of gold averaged about $12 billion a year in 2005-2008, but escalated to nearly $55 billion a year during 2012 and 2013. Due to the import restrictions and the decline in its price globally, gold import fell by 47 percent in 2013-2014. It revived subsequently, increasing by 10 percent yoy during April-December 2014, but remained below the levels seen in earlier years, see Box 4.

Services exports and remittances increased at a steady pace countering the impact of stagnant merchandise exports on the current account

Merchandise exports registered tepid growth during the first three quarters of 2014-15, primarily because of the decline in the exports of petroleum and gems and jewelry. The decline in global oil prices had an adverse impact on the value of exported refined petroleum products from India, which declined by 2 percent yoy during Apr 2014-Jan2015. Exports were subdued despite a 10 percent increase in exports to the U.S., India's largest export destination, as exports declined to other countries including China and Singapore. Remittances and services exports earnings continued to increase steadily as in the past years, and their outlook is considered robust (see Figure 22 and Box 5).

Figure 22: Services Exports and Remittances Increased at a Steady Pace; while Merchandise Exports Stagnated

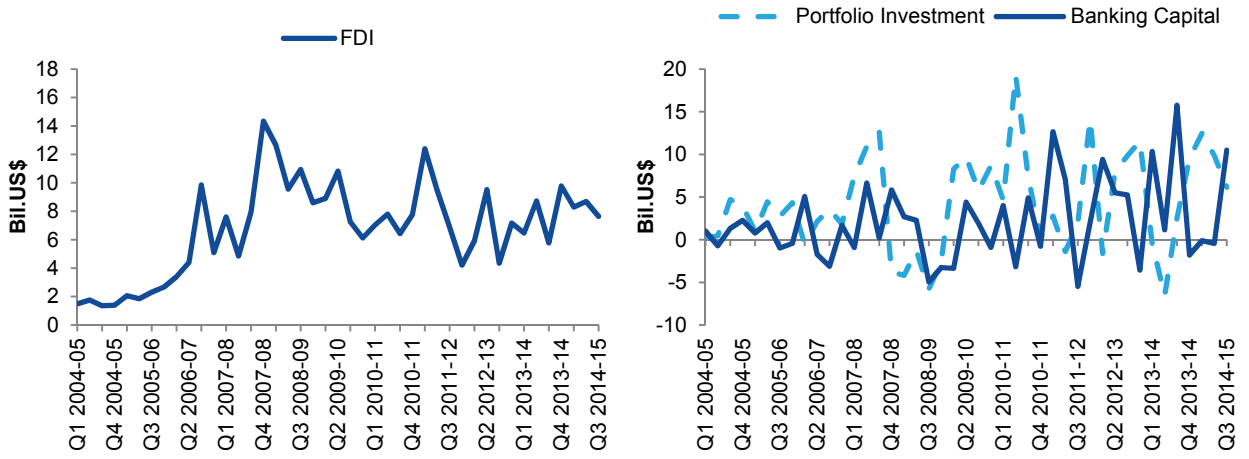


Source: Reserve Bank of India and Ministry of Commerce, India

FDI inflow and Portfolio flows helped finance the current account deficit and contributed to reserve accretion

Capital flows remained robust, foreign investment inflows (direct and portfolio) regained strength and reflected in an increase to 3.4 percent of GDP during Q1-Q3 2014-15 from 1.4 percent during 2013-14. As has been observed widely, FDI flows continued to be more stable than the portfolio flows, which along with bank flows exhibited volatility (Figure 23). The balance of flows shifted towards more volatile portfolio capital flows, which totaled about $28 billon in the first three quarters of the fiscal year, compared to FDI flows at nearly $24 billion.[16]

Figure 23: FDI inflows, and Portfolio inflows were Robust in 2014-15; but over the longer term while FDI Flows were relatively Stable, Portfolio Flows and Bank Flows Exhibited Volatility



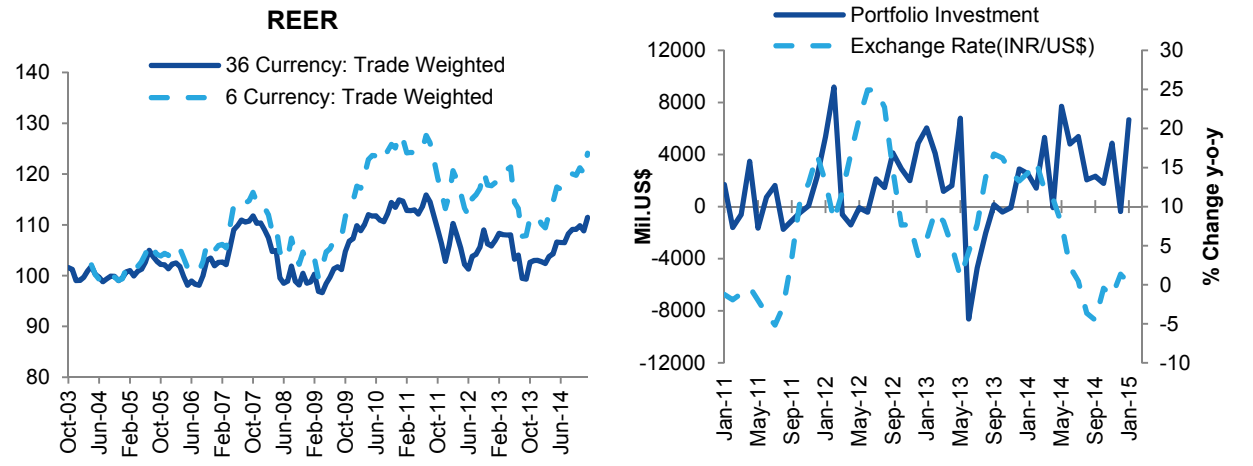
Source: Reserve Bank of India

[16] The government eliminated the regulatory distinction between different categories of foreign investment such as Foreign Portfolio Investors and Foreign Direct Investment; and proposed to amend the Finance Bill, Section-6 of FEMA to provide that the equity flows of both FDI and portfolio would be regulated by the Government, in consultation with the RBI.

After the sharp depreciation in the exchange rate in 2013, exchange rate appreciated in early 2014, and has been stable in the past few months

The relative stability of the nominal exchange rate, given India's inflation rate, translated in an appreciation of the real exchange rate (Figure 24). Competitive exchange rates are widely considered vital for exports growth, and the RBI's policy towards the exchange rate has been a subject of much debate (see e.g. Economic Survey). Portfolio capital flows in particular were correlated with the nominal appreciation of the rupee, necessitating vigilance and some intervention in the foreign exchange market by the RBI, as reflected in the accumulation of reserves in 2015.

Figure 24: While Nominal Exchange Rate was broadly stable, the Real Exchange Rate Appreciated



Source: Reserve Bank of India

Reserve Bank of India built international buffers as a "first line of defense", and took additional measures to reduce external vulnerability[17]

Benign inflationary conditions continue to prevail globally, aided by the decline in oil prices, allowing for accommodative monetary policies in developed economies. Even as the Federal Reserve Board has maintained its current stance on monetary policy for the time being, the expectations are rife that it would start tightening its monetary policy sometime in 2015, and possibly as early as in summer this year. In the event that a tightening of the US monetary policy disrupts capital flows to emerging markets, India being one of the large financial markets, and a large recipient of capital flows, could be adversely affected by this rebalancing. Just like the other emerging markets, India has also rebuilt its reserve buffer after the tapering talk episode, increasing it to $338 billion as of February 27, 2015, enhancing its coverage to meet sharp increases in the demand for foreign currency or the shocks to global liquidity.[18]

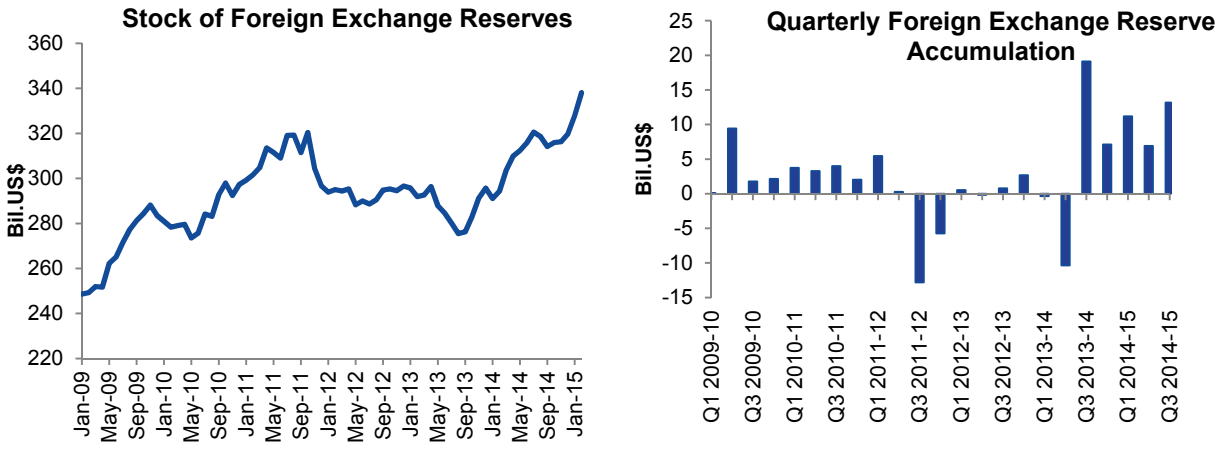
However a larger reserve cover should not be construed as a substitute for other important mitigation measures

The RBI officials have pointed out that a larger reserve cover should not be construed as a substitute for other important mitigation measures, such as hedging against currency exposures; or specific capital flow measures to avoid building short term external liabilities (especially portfolio debt flows). Recognizing the importance of these additional measures, the RBI has encouraged the corporate sector to hedge its exchange rate exposures, and has cautioned the banks to take a prudent view in lending to the corporates with unhedged positions. It sought to lengthen the maturity profile of the government and corporate debt held by foreign investors (to at least three years of minimum residual maturity) as an additional prudent measure.

[17] As indicated in a speech by Deputy Governor Mr. Harun Khan, February 24, 2015.

[18] The level of reserves that India has held in recent years is considered adequate on most adequacy metrics (including in the IMF's recent assessment of the Indian economy).

Figure 25: International Reserves Increased Providing a Buffer against External Vulnerability

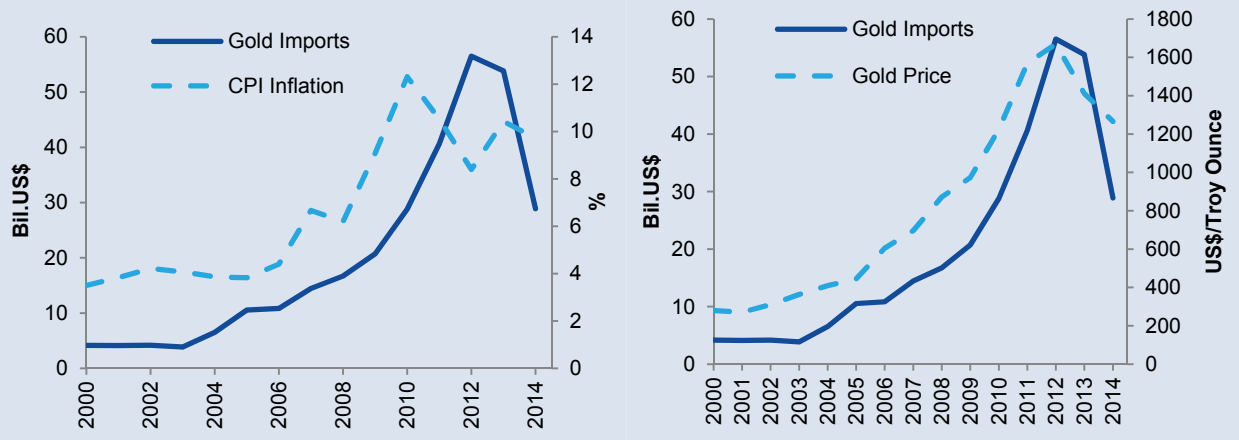


Source: Reserve Bank of India

Box 4: Recent development in gold imports

India traditionally imports a large amount of gold, about 850 tons a year, contributing nearly a quarter of the global demand. The demand for gold increased by about 20 percent starting in 2010, when it averaged 970 tons a year between 2010-2013, after averaging 750 tons in 2005-2008. Combined with high gold prices, it reflected in the import of gold escalating to nearly $55 billion in 2012-12 and 2012-13, compared to an average annual import of about $12 billion in 2005-2008. At these peak levels, gold comprised 10 percent of the entire import basket. The period in which gold imports increased coincided with high domestic inflation; as well as a rapid rise in the price of gold globally (Figure 26)--suggesting that the surge in the import of gold could be attributed to inflation hedging by Indian importers; when gold simply seemed a better store of value with its price increasing robustly.

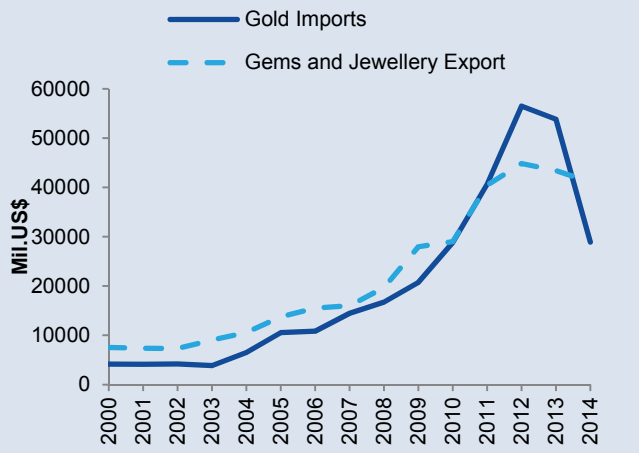
Figure 26: Gold Imports Correlate Positively with Domestic Inflation and With the International Price of Gold



Source: Reserve Bank of India, and IMF

Rising gold imports being partly responsible for the increase in current account deficit, the government announced several measures in 2013, both tariff and quantitative restrictions, to restrain their imports, see Table 5. It raised the import duty on gold to 6 percent in January 2013 (from 4 percent earlier), to 8 percent on June 5, 2013, 10 percent on August 13, 2013; and further the duty on the import of gold jewelry was raised to 15 percent on September 18, 2013. These were accompanied by restrictions, such as prohibiting the import of gold coins, and a 20/80 rule requiring that 20 percent of the gold imports would be made available to exporters while only the rest 80 percent could be used domestically. These measures helped curtail the import of gold; the import volume declined to 670 tons in 2013-14, while in value, imports declined by nearly $25 billion.

Figure 27: Along with the Import of Gold, Exports of Gems and Jewelry have Moderated Recently



Source: Reserve Bank of India

These apparently successful measures also raised some concerns. The main concern being that the import restrictions might have affected the exports of gold jewelry, by increasing the price of gold bullion, Figure 27; another concern is that the large difference between the domestic and international price of gold might have generated incentives for circumventing these measures by importing gold without declaring it to the customs.[19] The government and the RBI has lifted several of these restrictions recently, while the import duty has prevailed.

Table 5: Import Restrictive Measures on the Import of Gold

Date	Gold Import Measures
Jan-13	Import duty on gold raised to 6 percent from 4 percent
May-13	RBI allowed banks to import gold only on a consignment basis, bans Banks and NBFCs from lending against gold ETFs and MFs
Jun-13	Letters of credit opened by banks or gold import agencies to be on 100 percent margin basis
Jun-13	Gold import duty increased to 8 percent from 6 percent
Jul-13	Introduction of 20:80 scheme, i.e. 20 percent of every lot of gold imports to be used for exports
Jul-13	Restricted Star/premium trading houses to import gold "exclusively" for exports
Aug-13	Import duty on gold and Silver raised to 10 percent from 8 percent earlier
Sep-13	Import duty on gold jewelry increased to 15 percent
May-14	Trading houses (star/premium) allowed to import gold under 20:80 scheme
May-14	Banks allowed to provide gold metal loans to domestic jewelry manufacturers
Nov-14	Withdrawal of 20:80 scheme, and other restrictions introduced since August, 2013
Feb-15	RBI lifted the ban on import of gold coins and medallions by banks and trading houses

Source: Reserve Bank of India

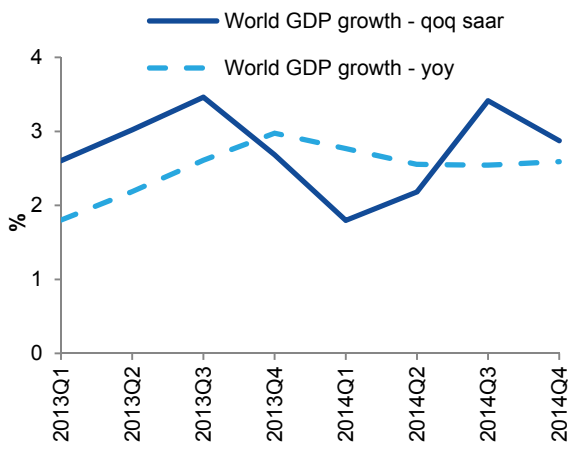
[19] The World Gold Council has estimated that due to these measures, nearly 200 tons of gold has been smuggled into India (see Reuters, July 10, 2014). Some recent news reports have confirmed such reports. http://www.euronews.com/newswires/2956910-india-seizes-record-haul-of-smuggled-gold-outside-airport/

8. Global Developments[20]

Global growth remains soft despite lower oil prices

While the sharply lower oil price is reflected in a significant pick-up in retail sales and falling inflation across major oil importing economies, global growth remains soft (Figure 28), reflecting divergent trends between oil importers and oil exporters and persistent headwinds in a number of large economies. Growth in the fourth quarter of 2014, annualized quarter-on-quarter, is estimated at 2.7 percent, down from 3.5 percent in the third quarter; a similar or slightly softer momentum is expected in the first quarter of 2015.

Figure 28: Global Growth Remains Soft



Source: World Bank, Haver Analytics

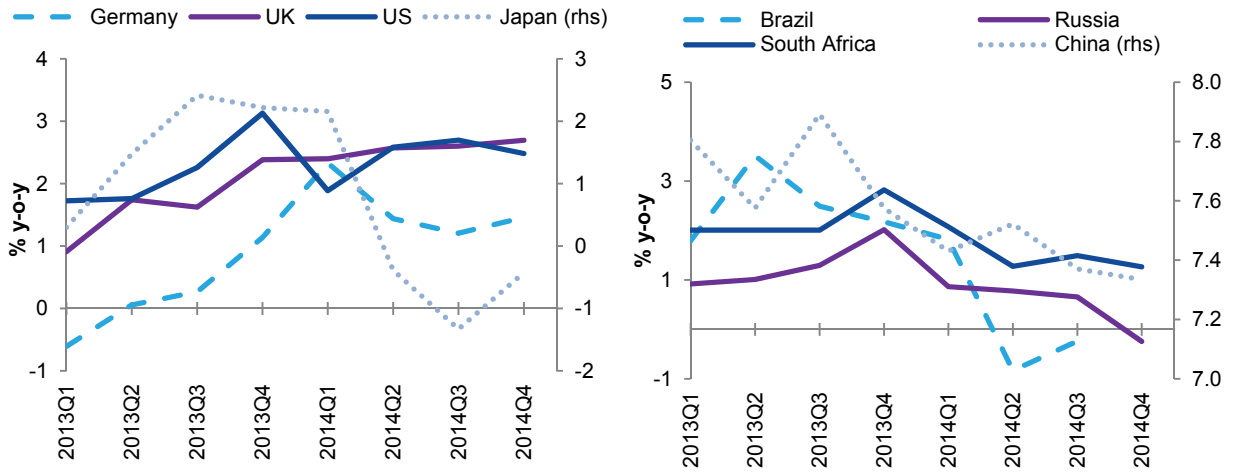
Growth lacks momentum among India's major trading partners and origin of FDI

The modest global growth outlook is further marred by divergent outlooks across countries and regions. In particular some of the economies bearing significant trade and financial links with India have registered slow growth. Countries that figure most prominently among India's export destinations include the UAE, Saudi Arabia, the broader set of GCC; as well as China, US and Europe. In inflows of foreign direct investment, the countries that dominate (after Mauritius and Singapore) include the US, UK, Japan and the larger countries in the Euro Zone.

Growth outcomes in these countries remained subdued in Q4, 2014 (Figure 29). Following an exceptionally strong third quarter, growth in the United States decelerated to 2.6 percent in the fourth quarter of 2014. The deceleration was accompanied by a marked shift in the composition of growth—while consumption picked up strongly, consistent with declining oil prices and strong labor market conditions; export growth slowed down, perhaps due to a stronger US dollar. In Japan, technically recession ended in the fourth quarter, with growth bouncing back to 2.2 percent; but the annualized, quarter-on-quarter increase was modest at 0.6 percent. Growth picked up in the Euro Area, but remains modest at 1.4 percent in the last quarter of 2014; with Germany posting a much stronger performance than initially predicted.

[20] The discussion draws on the World Bank (DECPG)'s monthly brief, February, 2015.

Figure 29: Growth remains subdued in India's Major Trading Partners, as well in its Peers



Source: World Bank, Haver Analytics.

Contagion risks from Greece are small for India

Since elected in end January, Greece's new government pushed for a renegotiation of its bailout program, which expired on February 28, but was extended by four months. This gave reprieve to the immediate concerns about a default and eventual exit of Greece from the Euro Area and restored the supply of deposits in the Greek banks. Hence the contagion risks are limited; and are further reduced with the large scale purchases of sovereign bonds that the ECB started in March. Sovereign bond yields in countries such as Portugal, Italy, Spain or Ireland barely changed in recent weeks and remained close to historical lows. India is at low risk of first order contagion from the evolving situation in Greece, with hardly any trade, financial or remittances links.

Oil importing emerging economies benefited from the decline in oil prices, but it did not prove sufficient to make their economic outlooks brighter

Growth decelerated to 6.8 percent in the fourth quarter (annualized quarter-on-quarter) in China, with declining contributions from net exports and housing investment. China's January trade data was markedly weak, with both exports (-3.3 percent yoy) and imports (-19.9 percent yoy) declining. Even so, China's current account remains in surplus. Its net capital flows turned into deficit in the last quarter of 2014, while capital outflows were manageable, they pose additional policy challenges for Chinese authorities. In Indonesia, growth momentum remained relatively soft as the positive impact of a sharp drop in oil prices was partly offset by declining prices of coal and crude palm oil impacting export revenues. Despite lower oil prices, inflation in Brazil has been ticking upwards amidst weakening retail sale; justifying the central bank's continued hikes in interest rates. Industrial production contracted further in the final quarter of 2014, dimming prospects of significant recovery in the short-term.

Headwinds are expected to intensify in oil exporting economies, with some possible implications for India

Slowdown in the Middle East may adversely impact the demand for Indian exports as well as remittances flows originating in the regions (though the effect may not be quantitatively significant, see Box 5). Among other larger oil exporting emerging countries, Russia has been severely affected by declining oil prices, compounding the impact of international sanctions that it faces. While its foreign reserves continued to decline in January and February this year; its GDP is predicted to contract significantly in the first quarter of 2015. Nigeria has also shown signs of increasing vulnerability, with low foreign exchange reserves, a deteriorating fiscal position and increasing political uncertainty. Sentiment and activity have been slightly weaker than expected in Mexico. Individually, however, the growth

outcomes in these countries are unlikely to be of much consequence to impact trade, or financial flows to India.

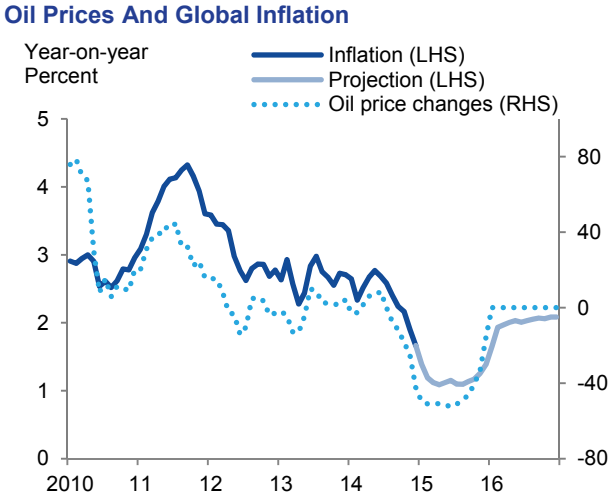
Oil prices are expected to remain low, and aide in improving further the fiscal outcomes and current account balance in India

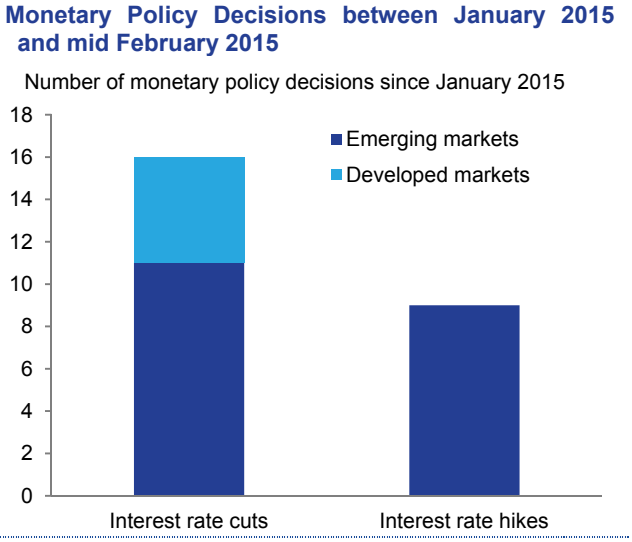
Crude oil prices increased during February after hitting a 6-year low in late January, due to downward adjustment in the US oil supply capacity, even as OPEC continues to maintain supply levels. Brent (the international benchmark) gained $14per bbl, and WTI (a U.S. benchmark) gained almost $8per bbl from January 28 to mid-February, and declining again in March. Conflicting signals on U.S. production trends contributed to rise in oil price volatility. However, amidst ample global crude oil supply, prices are predicted to remain low in coming months, averaging $53per bbl in 2015 and $57per bbl in 2016.

Global inflation, and monetary policy outlook remains favorable at the moment; and capital flows to developing countries are holding

The sharp fall in oil prices since June 2014 is expected to cut global inflation by around 1 percent this year, with some advanced economies seeing a period of negative inflation during 2015. Developments in oil prices and inflation continue to impact the monetary policy stance (Figure 30). In the Euro Area, several months of deflation, triggered by falling oil prices, could further contribute to a de-anchoring of inflation expectations, supporting an aggressive easing of policy. In the U.S. a first interest rate hike is expected sometime later this year. Among large oil-importing developing countries, the combined effect of inflation moving towards policy targets, declining current account deficits and soft growth has allowed several central banks to cut interest rates since the start of the year, including Indonesia, Turkey, Romania, Egypt, Pakistan, South Korea, and Thailand.

Figure 30: Global inflation is reigning low and Monetary Policy has Been Accommodative in Advanced and Emerging Economies





Box 5: Remittances to India-Robust growth and resilience to domestic and external shocks

Having surpassed the annual volume of portfolio capital flows or official development assistance (ODA), remittances are known to be one of the largest and most stable external flows to developing countries. The World Bank (2014) estimates show that the magnitude of remittances flowing to developing countries increased from $324 billion in 2009 to $454 billion in 2014, and has been growing steadily over the years. After declining by nearly 6 percent in 2009, remittances rebounded quickly to grow at more than 10 percent in 2010, and at 12 percent in 2013. The resilience of remittances has not been uniform across countries though. It has depended crucially on the economic conditions in the host countries where a country's diaspora population lives; as well as on the kind of economic activities that the diaspora primarily engages in. Remittances could be affected adversely if there is an economic slowdown in the host countries, and particularly if the diaspora works in sectors which are cyclically more volatile, such as construction.

Remittances to India have been growing at a steady pace of more than 10 percent a year and have contributed significantly to the balance of payments. India has been the largest recipient of remittances in the world for several years. Looking at the long term trend in remittances that India receives (Figure 31), remittances were quite small up until 1990, but have grown rapidly after that. Their modest magnitude in the period before the 1990s is attributed to the financial and regulatory conditions prevailing at the time. Due to the low level of financial development, high cost and time to remit money, an appreciated rupee under the fixed exchange rate regime, and the restrictions that the central bank imposed on transactions in foreign currency, the flow of remittances was small and a fraction of remittances were routed through the unofficial channels, and not captured in the balance of payment.

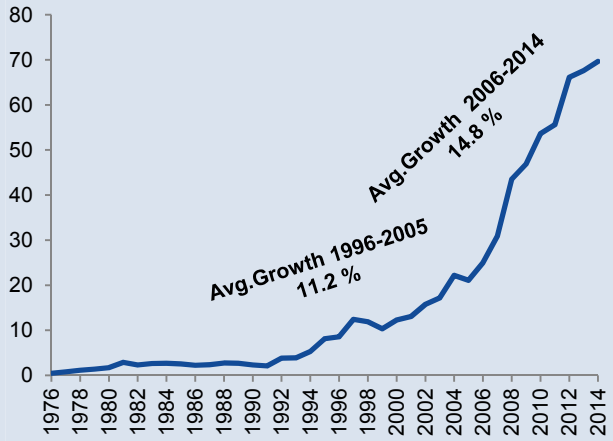
Several of these conditions changed with the liberalization in early 1990s when the currency was devalued by about 30 percent within a year and was later floated; the current account transactions were liberalized; and the financial liberalization and other technological advancements reduced the time and cost to remit money. Since some of these developments reduced the arbitrage in remitting money through unofficial routes, they were also more fully captured in the balance of payments. Remittances grew at a robust pace of 11 percent a year between 1996 and 2005 (Figure 31). A second spurt in remittances was evident in subsequent years, when they increased at 15 percent a year, consistent with the country's increased global integration through the trade of goods and services, financial flows as well as the movement of people.

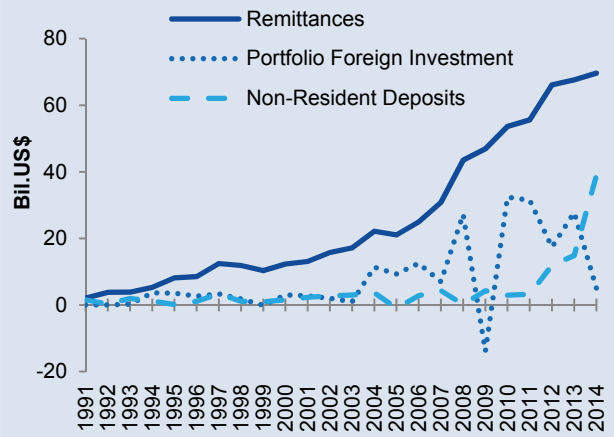
Remittances to India have been relatively stable—their annual movement is dominated by a linear trend, with very limited volatility observed around the trend.[21] Since a proportion of migrants from India are high skilled, and employed in sectors such as IT, health and education with weak cyclical volatility, the remittances they send home are relatively insulated from the business cycle conditions in their host countries. Remittances are also seen to be somewhat counter cyclical to economic growth in India—they tend to increase during economic slows downs; and possibly when the exchange rate is weak. In recent years, remittances are also seen to be responding to the movements in the domestic and international interest rates, and stock market valuations. In particular, an increase in domestic interest rates; a decline in international interest rates; or an increase in the Indian stock market index, are all seen to be associated with a modest increase in remittances.[22]

[21] Jadhav, Narendra, 2003, "Maximizing Developmental Benefits of Migrant Remittances: The Indian Experience," and Gupta, Poonam, 2006, "Macroeconomic Determinants of Remittances: Evidence from India", *Economic and Political Weekly* show that remittances flows have been more stable than non-resident deposits or portfolio flows.

[22] Gupta, Poonam, and Karan Singh, 2010, Trends and Correlates of Remittances to India, Migration Letters, Vol. 7 (2), indicate that perhaps just like other financial flows, remittances in recent years are driven partly by an investment motive, and affected by the prospects of relative earnings in the native and host countries.

Figure 31: Remittances picked up in mid 2000s to grow at 15 percent annually; Contributing Significantly to the Balance of Payments





Sources: Reserve Bank of India, and Migration Database, World Bank.

Source: Reserve Bank of India

The outlook for remittances to India is considered robust, with some downside risks from an economic slowdown in the oil exporting countries in the Middle East and increase in the US interest rate. The World Bank Migration and Development Brief (2014) has predicted a robust outlook for global remittances, as well as for India. Remittances globally are expected to grow at 5 percent in 2014 to $435 billion, and at 4.4 percent to $454 billion in 2015; out of these India is estimated to receive $71 billion in calendar year 2014, increasing to $75 billion in 2015 and $78 billion in 2016. To the extent that remittances are positively associated with the access to banking, the ongoing drive on financial inclusion, under the Jan Dhan Yojana, is likely to facilitate the flows of remittances; while also contributing to consumption smoothing, that remittances are seen to be associated with. The downside risks to this outlook in the medium term include economic slowdown in oil exporting countries in the Middle East, which may impact the demand for expatriate workers in the region (the Middle East region is the largest destination of migrants from India, as indicated in the World Bank's data on bilateral stock of migrants). Additionally, to the extent that remittances respond to the interest rate differential, an increase in interest rates in the US, may also have a short term negative impact. These adverse impacts are likely to be counterbalanced by India's improved growth prospects that tend to attract investment-oriented remittances.

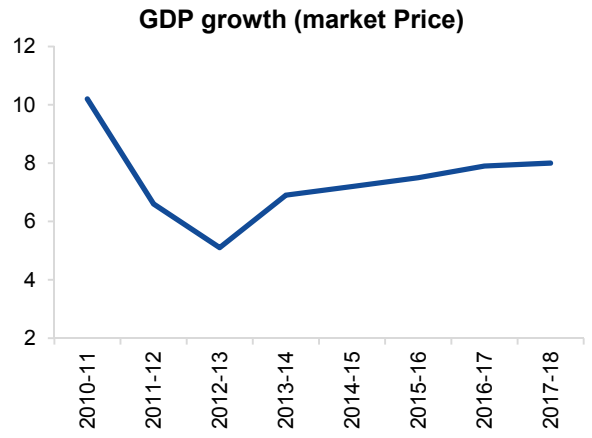
9. Outlook and Projections

a. Near-term outlook is positive on renewed reform momentum

India's economy is poised to accelerate in 2015-16 and 2016-17 as the reform momentum has picked up.

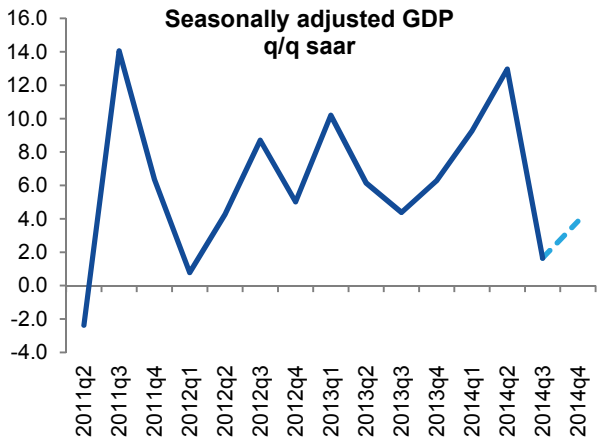
The outlook for the Indian economy is underpinned by two main trends: first, a relatively benign external environment, particularly low commodity prices, creates policy space; second, a reform program which, if fully implemented, can unlock investment and boost total factor productivity (TFP) growth. Higher production capacity, commensurate with capital accumulation and an increase in total factor-productivity, as well as continued fiscal consolidation, would help curb domestic and external imbalances in the face of rising domestic demand in the medium-term. This outlook is subject to substantial external and domestic risks. Meeting reform targets across the range of policy areas, undertaking wider reforms in factor markets, and scaling up infrastructure would be crucial for attaining the outlook and for the long-term sustainability of growth.

Figure 32: GDP Growth Forecast—Gradual Acceleration to Continue assuming Reforms Succeed in Unlocking Private investment



Source: World Bank staff estimates

Figure 33: Growth momentum declined in the third quarter



Note: The X12 ARIMA seasonal adjustments are developed by the US Census Bureau. The adjustemnts are done using the multiplicative method in Eviews, using the default Henderson filter, and without any adjustments for holidays.

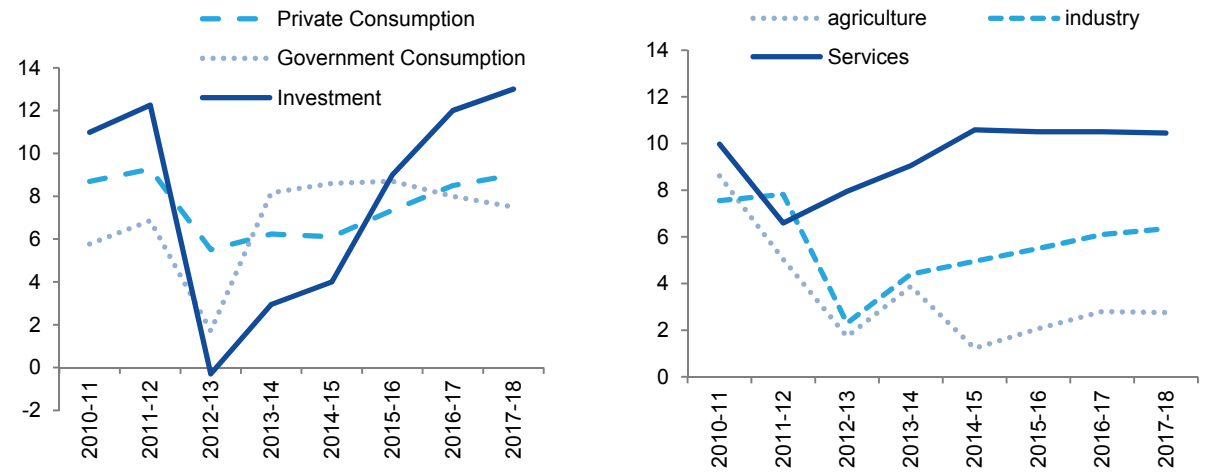
Real GDP growth (at market prices) is expected to register 7.2 percent in 2014-15, accelerating to 7.5 percent in 2015-16 and further to 8.0 percent in 2017-18[23]

GDP growth during 2014-15 is estimated at 7.2 percent of GDP (compared to 6.9 percent in 2013-14), below the authorities advance estimate of 7.4 percent, largely on account of some signs of slower momentum in Q3 2014-15. Momentum in most seasonally adjusted series, invariant of specifications, declined in the third quarter (see Figure 33), as did the y-o-y growth – driving the short term growth forecast.[24] However higher frequency information (such as on industrial production) suggest a pickup of momentum in the last quarter. Going forward, acceleration in real GDP growth would be driven largely by higher gross fixed capital formation, which is expected to grow at an average 11 percent annually during FY2016-FY2018 (Figure 34). Simultaneously, growth in government consumption expenditure is expected to increase in 2015-16 on account of an anticipated revision in public salaries under the ambit of the 7th Pay Commission. Private consumption expenditure is expected to respond more gradually and increase to 9 percent by 2017-18 from 6.1 percent in 2014-15.

[23] All forecasts are made using the revised (base year, 2011-12) national accounts series. The officially released series is available only from 2011-12. In order to statistically estimate relationships between different variables, a longer back-casted series (up to 1960) was constructed using growth rates.

[24] While the seasonal adjustments of a short time series (fifteen observations in the 2011-12 series) are volatile and noisy, the signs of slowing momentum are consistent across specifications.

Figure 34: GDP Growth Forecast is underpinned by Investment picking up, aided by Consumption Growth; Industrial growth would be crucial for Growth Acceleration



Source: World Bank staff estimates

Much of the pickup in GDP growth would be reflected in an expansion of the industrial sector in response to reform measures

If implemented fully, reforms are expected to improve the business environment and alleviate constraints to firm growth. Industrial output is expected to grow at 5.5 percent in 2015-16, and accelerate to 6.4 percent by 2017-18. The services sector, through backward and forward linkages to other sectors of the economy, could grow at an average 10.5 percent during FY2016-FY2018. Agricultural output, assuming normal rainfall in the forecasting period, is expected to grow at an average of 2.8 percent.

Household consumption growth is expected to expand along with economic activity.

Lower input prices in agriculture may support household consumption in 2015-16, but the year is getting off to a weak start due to excess rainfall in many areas. On the other hand, according to the consumer confidence survey conducted by the central bank, the future expectations index has increased by 22 percent between December 2013 and 2014 – reflecting significantly greater optimism of households and willingness to spend over the coming year. Under the assumption of robust growth as in the baseline, healthy labor market is expected to support household consumption growth to register in at 7.4 percent in 2015-16 and 8.5 percent in 2016-17.

Acceleration in fixed investments is predicated on the successful implementation of multiple substantive reforms.

These could be expected to accelerate fixed investment growth from 4 percent in 2014-15 to 9 percent in 2015-16 and further to an average of 12.5 percent in FY2017-FY2018. While part of the push to investments is expected to come directly from the reprioritization of public expenses towards capital formation, investments are also expected to benefit over-time from the measures adopted by the government to mobilize funds and incentivize infrastructure projects. Some of these include – encouraging PPP projects through a plug-and-play model which allows private developers to overcome earlier bureaucratic bottlenecks; reforming the business environment to encourage private investment; and incentivizing long-term domestic savings through low inflationary environment and diversified financial instruments.

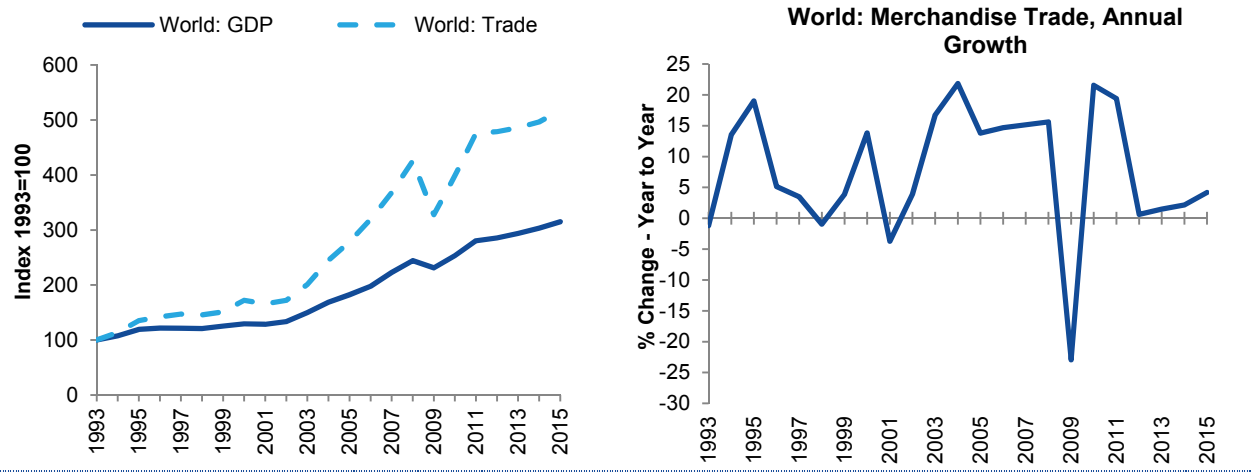
Export growth is constrained in the near term by both

While service exports have performed well, the share of Indian merchandise exports in world exports has stagnated, and merchandise exports have not contributed to the recent pickup in growth. While the new government has put a renewed

supply and demand conditions.

emphasis on increasing India's merchandise export growth, both supply and demand factors constrain the potential expansion of exports in near term. On the supply side, the Indian industrial sector has barely kept up with its global competitors as evidenced by India's stagnant share of global exports; while on the demand-side, the share of world exports to world GDP seems to have peaked (Figure 35). It would take a level increase in the competitiveness of the Indian manufacturing for it to carve a space for itself among the existing large exporters, within a market that seems to have peaked out. Although exports of services remain a bright spot and expected to continue to post double-digit growth in the medium-term, merchandise exports, similar to manufacturing output, are only likely to expand meaningfully once investments and productivity-enhancing reforms to labor, land, and capital markets are realized

Figure 35: Growth prospects of the world trade are subdued. After increasing far more rapidly than the global GDP until 2007, global trade has been growing at a slower pace than before



Source: World Bank.

Successful implementation of productivity-enhancing reforms would be expected to boost India's potential GDP[25]

While data constraints make it difficult to estimate potential GDP with precision, we estimate potential growth to nearly converge to 8 percent by 2017-18, from around 7 percent in 2013-14, assuming both a meaningful and sustainable pick-up in investment to increase capacity in the economy, as well as a pick-up in productivity growth. Commensurate with greater efficiency on account of the announced reforms, growth in total factor productivity is expected to accelerate during the forecasting period, approximately 30 bps higher than that in the previous decade.

Under the baseline scenario, inflationary pressures are likely to remain contained

Lower crude prices (which account for 6.8 percent in the consumer price index) would likely have spillover effects to food inflation; the improved production capacity drawing from the pickup in investment could prevent overheating in the medium-term (although a positive output gap is expected into 2017-18); and the recently adopted inflation targeting framework is likely to keep inflationary expectations anchored. In the baseline scenario, inflation is likely to decelerate to below 5 percent by 2017-18, approaching the RBI's target of 4 percent, with a band

[25] Estimates for potential GDP growth are based on a standard production function with labor and capital shares held at 0.7 and 0.3 percent respectively. Capital stock estimates from the old (base-year: 2004-05) national accounts series – have been converted to the new series using the relationship between the flow of capital formation in the new and old series. Labor force estimates are from the UN population projections.

of two percent around it. Some upside risks on food prices (with 46 percent weight in the CPI) may arise in the event of poor monsoons, unanticipated large increases in the minimum support price of food grains, or increase in oil prices.

The current account deficit is expected to narrow in the near-term but widen somewhat as investment growth picks up

The current account deficit is expected to narrow from 1.8 percent of GDP in 2013-14 to 0.7 percent of GDP in 2014-15 due to lower value of crude imports (which account for more than one-third of total merchandise imports), but could widen somewhat in later years as imports of capital and intermediate goods accelerate in line with the expectation of a pick-up in investment. Expanding domestic capacity and unlocking constraints to faster export growth would be crucial to ensuring the medium-term stability of the current account as well.

b. There are substantial external as well as domestic risks to the outlook

Effective policy implementation on many challenging fronts is required to realize the increase in investments embodied in the baseline scenario

While the government has embarked on energetic reform efforts across several areas, the current scope and pace of policy efforts may not prove adequate to unleash productivity and scale enhancement needed for the Indian firms to become globally competitive. As has been suggested by others, devolving more space to the states in some of the policy areas may produce enclaves of competitiveness and garner further support for wider reforms among the population and political classes across India. Should risks to the outlook materialize, especially with respect to investment-enhancing reforms, the growth rate could turn out to be significantly lower. The potential growth rate could be reduced in a "business as usual" scenario which restricts the growth in productivity, investments and industrial output at the last five year average, to below 7 percent by 2016-17.

To achieve the planned acceleration in public investments, the government will need to implement fiscal measures that protect infrastructure funding

These include containment of current expenditures, especially food and fertilizer subsidies; delivering on divestment plans, which has been a challenge in the past; and ensuring greater tax buoyancy than has been realized lately. Without parallel efforts on all these fronts, resource constraints may continue to limit public capital expenditures, as in the past. Effective implementation of the reforms to the PPP process would also be critical, while reforms to the business environment that have been initiated and are expected to be deepened further are also salient. Finally, given the larger devolution of tax revenue to the states, their efforts in boosting investments would also be important.

Within policy-related challenges to accelerate investment, perhaps the most significant stems from the banking sector

Measures to address the debt overhang and public sector bank's recapitalization would be required to achieve the pick-up in investments assumed in the baseline scenario. While some measures have been announced recently, including greater functional autonomy and strengthened management practices, recapitalization of selected banks through budgetary support, or equity market; more decisive measures would need to be taken given the underlying magnitude of recapitalization requirement and other medium term ownership related issues.

The recent economic turnaround as well as the outlook rests crucially on oil and commodity prices remaining close to current levels

The recent decline in inflation; reduction in current account deficit; and the fiscal space freed up by lower oil subsidies, stem from the recent decline in the international prices of oil, metals and food. These positive dynamics could unravel at least partially if prices fail to stay low, reinforcing the imperative for the government to insulate the economy more determinedly from the global price of oil. This could be done by weaning fiscal outcomes more fully from oil prices, by building in rules or procedures for domestic prices to align automatically with the import prices; by reducing the oil-intensity of the economy and encouraging alternative sources of energy including by mulling the possibility of using petroleum

taxation more actively; and by appropriating the current sweet spot moment to further rationalize the still high levels of subsidies on food and fertilizer.

India remains at risk of disruptive impact of potential tightening of the US monetary policy on its exchange rate and financial markets

Even though the Federal Reserve Board has maintained its stance on monetary policy, the broad expectations are that it would start tightening it sometime in 2015, and possibly as early as in summer, 2015. India being one of the larger financial markets, and a large recipient of capital flows, could be adversely affected by a rebalancing triggered by the tightening of the Fed's monetary policy. While the Reserve Bank of India has taken preventive measures to reduce external vulnerability, and has built international buffers as a "first line of defense", the risk remains, warranting vigilance.

Weather risks remain relevant

Although 2016 is expected to be a normal monsoon year, the effect of a poor monsoon (defined as rainfall below normal) season could lead to increases in food prices inflation of up to 0.5 percentage points, while reducing the agricultural output growth by 0.3 percent.

B. Selected Issues

1. Decline in Oil Process and Opportunities for India

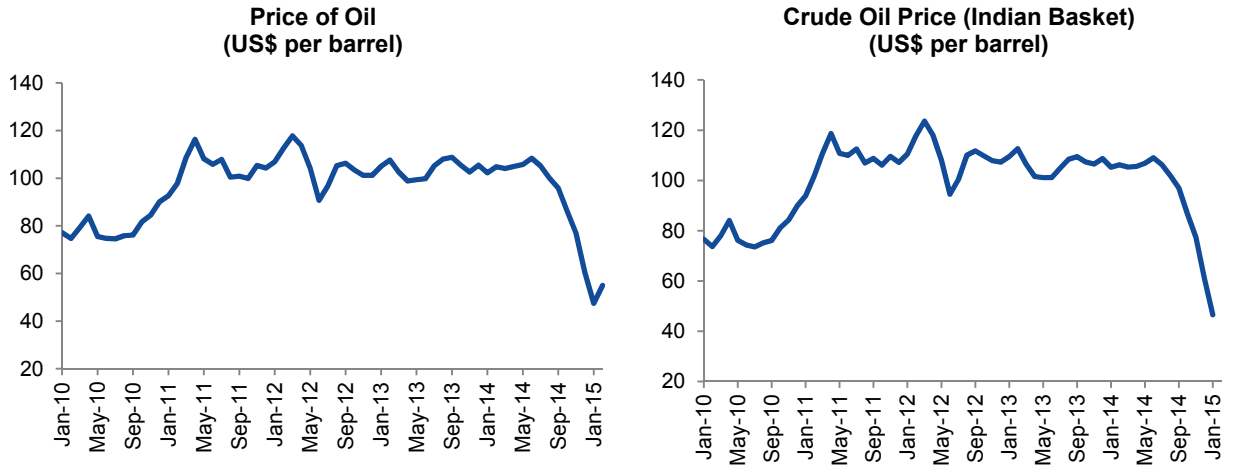
Global oil prices have fallen sharply, by nearly 60 percent, to below US$50 per bbl, between June 2014 and February 2015 (Figure 36). The decline is broadly attributed to a positive supply shock—the expansion of shale oil output in the United States, and OPEC's decision to maintain its market share; as well as to some moderation in global demand, due to continuing subdued global growth, and a decline in the oil intensity of production and consumption. The World Bank expects lower oil prices (US$53/bbl) to persist in 2015 and to rise only marginally in 2016 (US$57/bbl).[26]

The decline in oil prices is expected to have significant macroeconomic, financial and policy implications across countries. The effects would differ, conditional on whether a country is a net oil exporter or importer; the energy intensity of its production; and the tax and subsidies that apply on the production and consumption of oil products. On average, the decline in oil prices is expected to support economic growth, lower inflation, improve current account balances and the fiscal space in oil-importing countries; while the oil-exporting countries are likely to see weakening fiscal and external positions and negative impact on their economic activity. The overall economic impact, after netting out these country specific effects, is estimated to be positive. According to the World Bank, the oil price decline could increase global GDP by 0.7-0.8 percent over the medium term.[27]

[26] Commodity Markets Outlook, March 2015

[27] World Bank, Policy Research Note, 2015, "The Great Plunge in Oil Prices: Causes, Consequences, and Policy Responses".

Figure 36: International oil price has declined sharply since mid-2014 and is reflected in a decline in the import price of Indian oil Basket



Source: IFS; Ministry of Petroleum and Natural Gas, India

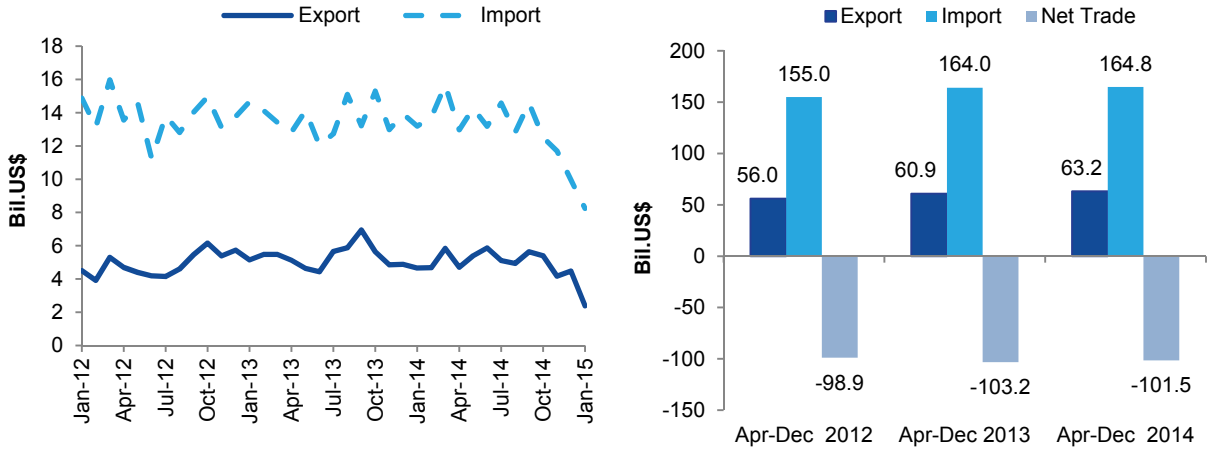
India being a net importer of crude oil, the impact on the Indian economy has been positive thus far. It has reflected in a modest improvement in the current account balance, some moderation in inflation, and crucially, in lower fuel subsidies and enhanced fiscal space. The government used the opportunity offered by low crude oil prices to increase excise tax rates on petrol and diesel, which is likely to further add to the fiscal space through enhanced tax collection.

a. India has benefitted on several fronts from the decline in global crude prices

(i) India, being a net importer of petroleum products, the decline in oil prices has helped reduce its trade deficit

India is a net importer of petroleum products. It meets more than three-fourths of its demand for crude oil through imports; which account for about 30 percent of all its merchandise imports. It is also a large producer and exporter of refined petroleum–accounting for nearly 20 percent of the total merchandise exports. In recent years, FY2012-FY2014, net imports of petroleum have averaged $100 billion a year. The petroleum import bill is sensitive to the movements in the exchange rate as well as the import price of oil. Oil and Petroleum Ministry's has estimated that an exchange rate depreciation of INR 1 per $ increases the net import bill by nearly $0.19 bn, and an increase in the price of crude oil by 1 $ per bbl, increases the net import bill by $0.24 bn. Hence unsurprisingly, as global crude prices started declining in June 2014, amidst relatively stable exchange rate, India's net import bill declined. The net impact has been a decline in trade deficit on petroleum products equal to about $2 billion during the three quarters of the current year (Figure 37).

Figure 37: India Imports Crude Oil and Exports Refined Oil and runs a Significant Trade Deficit on Petroleum Products; the Trade Deficit has declined due to the decline in oil prices



Source: Ministry of Commerce, India

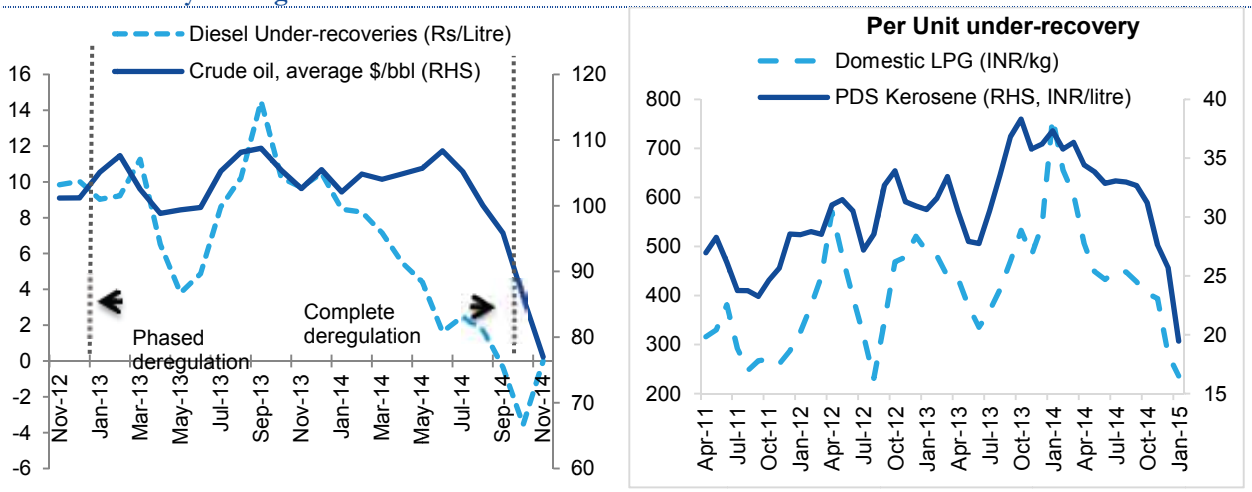
(ii) Decline in Oil prices has helped lower Fuel Subsidies, Generating some Fiscal Space

The marketing and retail of petroleum products in India has heavy involvement of public sector enterprises at all levels of the value chain –extraction of crude oil and natural gas (upstream activities); refining of crude oil and the retail and distribution (downstream activities). The consumption of petroleum products is dominated by four products—petrol, diesel, kerosene and liquefied petroleum gas (LPG); with variants within each of these products—e.g. branded and unbranded diesel and petrol; kerosene sold through the PDS or in the open market; and the LPG used for domestic or commercial use. The pricing mechanism, subsidies and taxes differ across these different products and their variants.

Until recently, the retail prices of petroleum products were administered by the central government; and the prices were set at below the cost recovery level, resulting in losses to the Oil Marketing Companies (OMCs). These under-recoveries, are borne by the central government (2/3rd of under-recoveries, in the form of petroleum subsidies) and upstream companies (1/3rd of under-recoveries). In 2013-14, OMCs incurred under-recoveries of approximately INR1.4 trillion (1.2 percent of GDP), and the government's share (equivalent to fuel subsidy) was 0.8 percent of GDP.

There have been efforts recently to link the retail prices of petrol and diesel more closely with their cost of production. Petrol prices were deregulated in June 2010, and currently vary with the trade parity price. Diesel prices were partially deregulated in 2013 when the OMCs were allowed to raise retail diesel prices by INR 0.50 per liter per month until their losses were recovered, and were fully deregulated in October 2014 (Figure 38). Due to these changes and the decline in the price of oil, under-recoveries incurred by OMCs have moderated, not just in deregulated diesel but also on kerosene and LPG, prices of which continue to be regulated. These are reflected in the government's fuel subsidy bill declining from 0.8 percent of GDP in the previous year to 0.5 percent of GDP during 2014-15. With the deregulated prices of petrol and diesel, and the low crude prices prevailing, the subsidy bill is expected to decline further to 0.2 percent in 2015-16 (the Budget estimates).

Figure 38: After Increasing Impressively in the mid-2000s, Savings and Investment Ratios have declined, and Rebound is not yet in Sight



Source: Ministry of Petroleum and Natural Gas, India

Even though LPG and kerosene remain subsidized and their prices are still at a level that results in under recovery of costs; the government has tried to restrict the amount of subsidy availed on LPG by lowering the number of subsidized cylinders per family. In 2013, the number of subsidized cylinders was reduced to nine; and more recently in 2014, rather than subsidizing the cylinders upfront, the government has sought to sell them at market prices, and transfer the subsidy to consumers through cash payment on twelve cylinders per year.[28]

Table 6: Under Recoveries on Diesel and Petrol have eliminated but persist on LPG and Kerosene

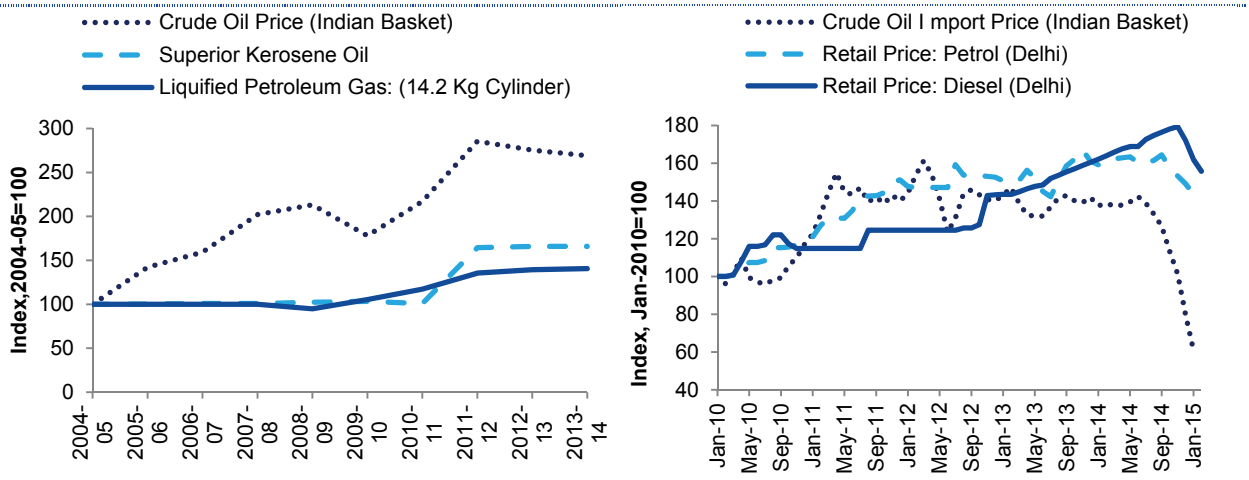
	2013-14	April-December 2013	April-December 2014
	Per Unit Under Recovery (INR per Liter or Cylinder)		
Diesel	8.39	8.49	2.70*
PDS SKO	33.98	33.12	31.69
Domestic LPG	499.52	440.39	428.31
	Total Under Recovery (INR billion)		
Diesel	628.37	476.55	109.35*
PDS SKO	305.75	223.73	212.16
Domestic LPG	464.58	306.04	349.41
Total	1398.69	1006.32	670.91

Note: *Deregulated from 19th October, 2014
Source: Ministry of Petroleum and Natural Gas, India

Following their deregulation, the retail prices of diesel and petrol have kept pace with the increase in oil prices (Figure 39), albeit they are smoother than the import price; the pass through has been much lower for kerosene and LPG prices.

[28] The Center commenced the Modified Direct Benefit Transfer Scheme for cooking gas (DBTL) in November 2014. Under the scheme, consumers would purchase LPG cooking fuel at market prices and receive the requisite cash subsidy directly in their registered bank accounts. The scheme covered 54 districts in its first phase, and was extended to another 246 districts from January 2015. The consumers who do not wish to avail the subsidies can voluntarily opt out.

Figure 39: Retail prices of Petrol and Diesel Correlate with the Import price; but Kerosene and LPG prices do not



Source: Petroleum Planning and Analysis Cell and Indian Oil Corporation Ltd., India

(iii) Government Seized the Opportunity offered by low oil Price to Increase Taxes on Petrol and Diesel, further adding to the Fiscal Space

Various petroleum products attract different taxes from the Central and State governments, Table 7. While the Central Government collects customs duty (ad valorem) and excise revenue (per unit of sale); states impose the sales tax/VAT, with rates differing substantially across states. An example of how these various taxes get reflected in the retail prices is in Table 8.

Table 7: Customs and Center Excise Duty on Petrol and Diesel as of January 2015

	Customs	Excise (INR/Liter)
Petrol	2.5%	INR 17.46/liter (works out to nearly 30 % of the retail price in Delhi)
Diesel	2.5%	INR 10.26/liter (works out to nearly 22 % of the retail price in Delhi)
Non PDS Kerosene	5%	14%
Non Domestic LPG	5%	8%

Source: Petroleum Planning and Analysis Cell, India

Table 8: Break up of Retail Price of Petrol and Diesel in Delhi in end January 2015 (INR/Liter)

Product	Petrol	Diesel
Price before taxes and dealer commission	27.82	29.14
Central Taxes	17.96	10.80
State Taxes	9.55	5.43
Dealer Commission	1.99	1.25
Retail Selling Price	57.31	46.62

Source: Petroleum Planning and Analysis Cell, India

Leveraging the decline in international crude prices, the government raised excise duties on petrol and diesel multiple times between mid-November, 2014 and mid-January, 2015, as indicated in Table 9 below. While there are no precise estimates of additional excise revenues expected to be generated from these hikes, some estimates reported in the media suggest additional revenues could be around INR 200 billion during 2014-15, and perhaps much larger the next year.

Table 9: Increase in Excise duty on Diesel and Petrol between November, 2014-February, 2015

	Diesel	Petrol
	Excise Level Before November 14, 2014 (per liter)	
	1.46	1.20
	Increases in Excise Rates (per liter)	
November 14, 2014	1.5	1.5
December 2, 2014	1	2.25
Jan 1, 2015	2	2
Jan 16, 2015	2	2

Source: Government announcements

(iv) Decline in Oil prices also made a Modest Contribution to lowering Inflation

Impact of the decline in global oil prices on inflation in India depends on the transmission of international prices to retail prices, and any changes in the State and Center taxes and subsidies, as well as the weight of petroleum products in the inflation index. After accounting for taxes and subsidies, decline in global crude oil price led to a moderation in retail fuel inflation to 3.4 percent yoy during Oct 2014-Jan 2015, though its contribution to the overall decline in CPI was rather modest due to its low weight in the CPI index.[29] A decomposition of the decline in CPI inflation during April 2014-Jan 2015 showed that of the 3.10 percentage points decline in inflation over the same period, previous year only a 20 bps decline (0.2 percentage point) was contributed by the decline in fuel prices.

b. The decline in oil prices helped generate important fiscal and current account savings; but the opportunity could be seized to deepen price and subsidy reforms and generate durable policy buffers

The recent decline in oil prices has generated net benefits for the economy, and has been partly responsible for the recent turnaround in the economic narrative, underpinned by a decline in inflation; reduction in current account deficit; and the fiscal space freed up by lower oil subsidies. Low oil prices have presented the government with a unique opportunity to insulate the economy more determinedly from the global price of oil, while generating larger resources to enhance public investment on infrastructure. This has been done by deregulating prices to move with the import parity price, and by increasing taxes on petrol and diesel; while improving the delivery of fuel subsidies on LPG. These efforts could be reinforced further by weaning fiscal outcomes more fully from oil prices; reducing the intensity of economic activity to imported oil, while encouraging alternative sources of energy; as well as mulling the possibility of creating additional fiscal buffers by using petroleum taxation more actively; and by appropriating the current "sweet spot" moment to further rationalize the still high levels of subsidies on food and fertilizer.

[29] The weight of fuel and light in the CPI basket (combined rural and urban) is 6.8 percent, and petroleum products being a component of this category, the direct weight of petroleum product is lower. However to the extent that petroleum prices affect other components in the consumption basket, particularly transport (which is clubbed in another category with communication), we use 6.8 percent weight for the price of petroleum products in the basket.

2. Is MGNREGS cost-effective against poverty?

The National Rural Employment Guarantee Act, passed in 2005, guarantees to each rural household 100 days of work per year on local public works. Nearly ten years into its existence, the sheer scale of the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) is impressive. With over 50 million beneficiary households, and expenditures between 0.5 and 1% of GDP, it is amongst the largest anti-poverty programs in the world.[30] Yet the jury is still out as to whether the program has been effective in reducing rural poverty, and whether alternative policies, such as universal cash transfers would be more cost-effective.

a. The Promise of Workfare

MGNREGS has the potential to reduce poverty in several ways. The most direct route is by providing extra employment and income to the poorest in rural areas. Such workfare schemes are built on the assumption that it is the poorest who will participate in them, and that people will readily turn away from the scheme when better opportunities arise. In other words, workfare schemes are self-targeted and therefore, cost-effective if implemented well.

Second, the scheme can reduce poverty by creating assets of value to poor people, either directly or indirectly, by generating jobs through creating essential infrastructure such as rural roads that can, in turn, support private enterprises.

Other indirect channels of impact can also be expected. It can provide rural laborers a bargaining chip in wage negotiations with private employers. This can, theoretically at least, allow them to secure higher wage rates for similar activities of casual labor, thus benefitting workers even if they don't participate in the scheme. A

[30] Official website nrega.nic.in

guarantee of employment can also provide crucial insurance benefits against shocks. There may be other non-pecuniary benefits to participants: it could provide someone with a viable alternative to working for the local landowner, thus empowering them in other ways.

If these benefits were to be realized, the scheme has the potential to drastically cut poverty. Analysis of household survey data from Bihar shows that under ideal conditions, the rural poverty rate of 50% at the time of the survey could come down by at least 14 percentage points.[31] In an ideal world, everyone who wants work should get it, up to 100 days per household per year, at the stipulated wage rates, without having to give up any other employment opportunity to take up the work. If anything, this is an underestimate because it ignores spillover effects to casual wage rates for other unskilled work; it also ignores other indirect impacts on poverty stemming from the creation of assets that could support economic activity such as rural roads or check dams to improve agricultural productivity.

b. Debates about MGNREGS

In reality, the performance record is mixed. Paradoxically, the scheme has worked less well in poorer states, where it is needed the most. At one end of the spectrum, the scheme is shown to have delivered significant positive impacts on a range of outcomes -- from consumption and nutrition, to quality assets and productivity improvements, particularly for the poorest – in Andhra Pradesh.[32] At the other end, impacts of the scheme in Bihar fall far short of potential. Compared to a potential reduction in poverty by 14 percentage points, actual impact on rural poverty is only about 1 percentage point.[33]

It is against the backdrop of a mixed record that debate has arisen recently about how effective MGNREGS can be in reducing poverty. There are two strands of thought on the future of the program. One strand turns on issues of program implementation—what are the key bottlenecks that hold back impact; and what will it take for the scheme to work better, particularly in the poorest areas? Much has been written about how the program could be made more effective by systematically building awareness, employing tools of e-governance, community-based monitoring, and strengthening local capacity. Dovetailing MGNREGS with other schemes to create productive community assets is another area of possible emphasis.

The other strand of thought questions the very rationale of the scheme, asking whether it is inherently cumbersome and if there aren't simpler alternatives to achieve similar poverty reduction objectives within the same budget. Advocates of this stream of thinking envision India's social protection system moving towards a universal cash transfer, or basic-income support (BIS) scheme, that guarantees a fixed cash transfer to every person, whether poor or not. Drives to open bank accounts (most recently, under the Jan Dhan Yojana), the system of national identity cards (Aadhaar), combined with near-ubiquitous mobile technology – the so-called "JAM trinity" -- can pave the way for such a scheme.

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[31] Dutta et al. (2014)

[32] Deininger and Liu (2013)

[33] Estimate from Dutta et al (2014) based on a survey of over 2700 rural households in Bihar in 2009 and 2010. The sample was representative of rural Bihar.

Whether or not MGNREGS is more cost-effective than an alternative such as a BIS scheme depends on how well either is implemented. So the two strands outlined above are closely interlinked. In the remainder of this section, we draw on lessons from Bihar and other states to bring evidence to bear on these debates.

c. Performance of MGNREGS: Explaining the Gap between Potential and Practice

There are a number of reasons why the potential impact of MGNREGS may not be realized in practice: the supply side may be slow to respond to the demand for work on the scheme, leaving un-met demand (rationing); workers may be unable to meet productivity norms for earning the minimum wage; there may be delays in wage payments; corruption at different steps could hold back the program; and assets created may not be durable and productive.

Understanding the relative importance of different factors helps to direct attention to the key bottlenecks in implementation. In Bihar, more than two-thirds – about 10 percentage points – of the gap between potential and actual impacts is attributable to the ways in which the scheme is not fulfilling the provisions of the Act. The rest is due to the foregone income, i.e., an opportunity cost to the worker from giving up alternate employment in order to take up MGNREGS work. Forgone incomes are hard to avoid, but are important to the calculus when evaluating the net income gains from MGNREGS participation and its cost-effectiveness against other alternatives (as discussed further in the next section).

High levels of unmet demand for work on the scheme constrain poverty impacts

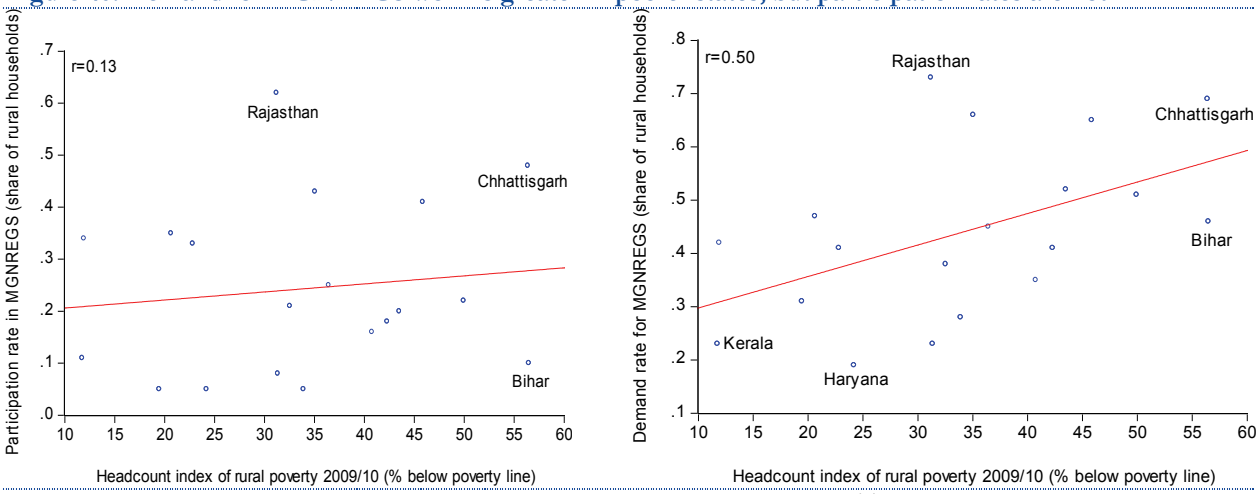
If MGNREGS worked in practice the way it is designed, there would be no unmet demand for work. At an All India level, 2009-10 National Sample Survey (NSS) data show a great deal of unmet demand.[34] 46% of households report that one or more members of their household would have liked to work on the scheme; only 25% secured any work over the course of the year.

Participation rates in the scheme are not, as a rule, any higher in poorer states. There is greater demand for work on the scheme in poorer states, but also a lower capacity to meet that demand (Figure 40). As a result, the degree of unmet demand or rationing, i.e., the fraction of people who wanted work but did not get it, is bigger in the poorer states.

In Bihar, unmet demand alone accounts for nearly three-fifths of the gap between potential and realized poverty impacts.

[34] Administrative data indicate virtually no unmet demand for work on MGNREGS. This is deceptive because what is called "demand for work" in these data is the official registration of demand. A better measure of demand is available in the NSS which asks respondents if anyone in their household got work, sought but did not get work, or did not seek work on the scheme.

Figure 40: Demand for MGNREGS work is greater in poorer states, but participation rates are not



Note: Participation rate is the share of rural households working on MGNREGS. The demand rate is the share of rural households that want work on the program. Estimates based on National Sample Survey 2009/10. *Source:* Dutta et. al. (2012).

High rationing weakens labor market responses to the scheme

The extent of rationing has important implications for the scheme. It makes the scheme a less credible fallback position for the rural laborer seeking work, and limits the spillover effects onto the private wage-labor market. It also undermines the insurance benefits of the scheme, which depend crucially on workers being able to turn to the scheme when it is needed.

There are many anecdotal observations of MGNREGS contributing to a steep rise in wages for unskilled labor. Studies of the impacts of the scheme on market wages for unskilled labor produce mixed results. Zimmerman (2013) finds little evidence of any labor market effects. Berg et al. (2012) and Imbert and Papp (2013) find positive effects on wages, but only in states where implementation is of high quality and intensity, and hence where the demand for work is more likely to be met. Azam (2012) finds wage impacts but only for women. The Bihar survey shows that market wages have been catching up with the MGNREGS wage but do not respond in a predictable pattern to changes in the stipulated wage for the scheme.

Leakage is substantial even though it is nowhere near as large as some casual observers have claimed

Despite government's efforts to promote transparency and encourage monitoring from administration and civil society (social audits), MGNREGS is plagued by leakages. Leakage can take multiple forms, such as inflating the number of days worked per person, or registering fake persons to siphon off funds. Comparison of MGNREGS aggregate levels of employment reported in official data with independent measures based on household surveys show that the gap exists, but the range of available estimates is too wide to be conclusive. NSS-based estimates for 2007-08 can confirm only a quarter to half of MGNREGS employment recorded in official reports, depending on the method used.[35] Specialized surveys with more

[35] The approach of estimating leakages by the shortfall in estimated total employment relative to days of employment recorded in the administrative data has been used in the literature (Bhalla 2011,

detailed questions on participation and remuneration in the scheme suggest substantially lower estimates of leakage. For instance, the Bihar survey of MGNREGS implies a 20% gap between survey-based estimates of employment and official data in 2008-09 compared to the 2007-08 NSS-based estimate of 70% gap in the state.

From wage gaps to payment delays – the nature of bottlenecks have evolved over time

Discrepancies between the scheme's stipulated wage rates and actual wages received by workers also contribute to the gap between potential and realized impacts. In Bihar, on average, workers on the scheme received about 10% lower wages than the stipulated rate. This gap is not due to payment delays, as the gaps are estimated on total wages owed to the individual, not the amount actually received by the time of the survey.

More recently, payment delays have emerged as a major bottleneck in program administration, and are a strong disincentive to participating in the program. National surveys highlight variation amongst states – in 2009/10 a survey found nearly 68% of MGNREGS beneficiaries received wages within 15 days in Andhra Pradesh. The same estimate for Rajasthan and MP were 10% and 23%.[36]

d. Stacking-up MGNREGS against a Cash Transfer

How do the impacts of MGNREGS, as implemented today, compare to the potential impacts of a universal cash transfer based on the same aggregate budget?

MGNREGS attains better targeting than a universal cash transfer. However, it entails higher costs.

In a Basic Income Scheme, there is no explicit effort at targeting or reaching only, or even primarily, the poorest. MGNREGS, by contrast, has an in-built self-targeting mechanism and most studies show that despite the substantial unmet demand, participation in the scheme favors people from poorer families. Greater participation by the poor reflects both higher demand for work on the scheme amongst poorer households, and a rationing process that is pro-poor.

Relative to workfare, BIS holds two cost advantages. First, workfare schemes incur non-negligible other costs that would not be spent in alternative cash transfer schemes. Public works require outlays on material inputs as well as on hiring relatively skilled labor for organizing and supervising the worksites. Even in the highly unskilled-labor intensive schemes seen in South Asia, these "non-wage" costs account for about one-third of the public outlay. Administrative costs of a cash transfer scheme can be expected to be lower, particularly if transfers are automated after an identity and financial infrastructure is in place.

An added cost of workfare, relative to a BIS scheme, is borne by participants themselves. If participants have to give up other employment opportunities in order to work on the scheme, net gains from participation will be lower than the scheme wage, with implications for eventual impact on poverty. As a result, workfare tends to be advocated in places, or at times, with high unemployment, such as during

Himanshu 2010, Imbert 2015). It is a crude estimate which depends on the accuracy of the survey-based estimates and of the administrative data.

[36] NSSO (2011)

recessions, famines or lean agricultural seasons. Advocates of workfare schemes often assume (explicitly or implicitly) that workers would be idle in the absence of the scheme. Whether or not the assumption of zero alternative employment opportunities and income is plausible depends on the context. In Bihar, while alternative opportunities that MGNREGS participants give up to work on the scheme are less remunerative, forgone income is nonetheless significant.

Even with better targeting, MGNREGS would not be cost-effective unless assets created are of sufficient value

Factoring in forgone incomes and non-wage costs, and focusing only on the wage gains, the Bihar study finds that MGNREGS has less impact on poverty than a universal cash transfer would have had based on an equivalent aggregate budget. The simulations assume that in the cash transfer scheme, every household (whether poor or not) is given their share of the same sum of money as was spent on MGNREGS. However, this comparison does not take account of the asset creation under MGNREGS, or other potential non-pecuniary benefits. The simulations ask whether the wage earnings alone can justify the scheme as a more cost-effective means of reducing poverty, relative to a cash transfer. The results show that even if forgone incomes are substantially overestimated, a cash transfer dominates; results are also robust to the choice of poverty line over a wide range. A cash transfer is still an improvement over MGNREGS even if it is assumed to have the same extent of leakage or administrative costs.

In sum, even though MGNREGS is better targeted than a cash transfer scheme would be, wage earnings alone are not sufficient to make it more cost-effective at reducing poverty. But, it could be, if the assets created under it are of sufficient value to the poor. Other non-pecuniary benefits – like empowerment for socially vulnerable groups including women -- would further strengthen the case for workfare.

e. Two Directions for Reform

Can the scheme be reformed to work better in practice? Forgone incomes are not easily controlled by such a program. The gaps between the stipulated wage rates and wages received, and payment delays might be reduced. Pro-poor reform could also reduce the substantial unmet demand for work on the scheme. This could be done by enhanced public information and a more responsive supply side. These would enhance the impact on poverty, including through larger impacts on wages in the private casual labor market. The greater impact on poverty would come at a greater cost to the public budget. Cost effectiveness would need to be re-assessed at the implied higher level of funding.

Growing experimentation and experience across states, particularly in the use of information technology or e-governance, has produced promising results. Investment in tightening up program administration, fund flows, and transparency safeguards has yielded a reduction in program leakage (Dréze 2014, Imbert 2015), reflected in reduced nation-wide leakage estimates between 2009-10 and 2011-12 in the NSS data, and much lower estimates from the India Human Development Survey. Studies in Bihar and Andhra Pradesh (Banerjee et al. 2014, Muralidharan et al. 2014) highlight how re-engineering fund-flows through use of technology can reduce leakage and improve wage payment processes at the last-mile. The use of biometric identification yielded a 35% drop in leakage levels for the program in Andhra Pradesh.

A second, and complementary, direction for reforms is to ensure that workfare is productive—that the assets created are of value to poor people (or that cost-recovery can be implemented for non-poor beneficiaries). This is a vital ingredient to the success of the program. The on-going efforts at convergence of the scheme with other programs to build a range of assets are steps in that direction. Policy choices may well need to confront a trade-off. Depending on the types of works, meeting the extra demand for work may make it harder to assure that the assets are indeed of lasting value. The public choice made in response to such a trade-off will depend on the weight attached to reducing current versus future poverty.

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ANNEX: REFORM MEASURES

The government announced several reform measures throughout the year, complimenting them with further measures in the annual budget. These spanned a vast spectrum of policy space including the labor market reforms, easing the business environment, fiscal prudence and improving the efficiency of transfer benefits and the quality of spending. If implemented fully they could unleash private investment, both domestic and FDI, in various sectors; make social spending more efficient, and help shift the orientation of public spending to capital expenditure. For these reforms to bear maximum mileage, these ought to be implemented in earnest, and accompanied by complimentary reforms by the states. They need to be extended to explore innovative ways to raise long term financing, as well as make the banking sector, especially the PSBs healthier and more efficient.

A summary of these reform measures is provided below. [37]

Monetary Policy

- The government and the RBI signed the monetary policy framework, referred to as the "flexible inflation target" framework, wherein they agreed to a Target to bring CPI inflation below 6 percent by January 2016 and to 4 percent within a band of (+/-) 2 percent around it, by the end of 2016-17 and subsequent years thereafter. The objective was described to "primarily maintain price stability while keeping in mind the objective of growth".
- The agreement described as putting the RBI in charge of determining the policy rate or any other monetary measures to achieve the target; and to have the freedom to decide on, and to publish, the operating target and the operating procedure of monetary policy.
- It would also be required to bring out a document every six months explaining the sources of inflation and a forecast for inflation for the following 6-18 months.
- It further described that the central bank would be deemed to have missed its target if inflation exceeds more than 6.0 percent for three straight quarters in 2015-16 and all subsequent years; or if inflation is below 2.0 percent for three straight quarters in 2016-17 and all subsequent years. If the RBI is thus deemed to have failed to meet the Target, it would have to send a report to the government citing the reasons behind "the failure to achieve the target", propose remedial actions to be taken by the RBI; and provide an estimate of the time period within which the target would be achieved after implementing the proposed remedial actions.

Financial sector reforms

The government and the central bank worked in tandem to initiate several financial sector reforms. These reforms when fully implemented are likely to have far reaching implications for growth, on improving the efficiency of social spending, help the poor smooth consumption and to be able to save and invest more prudently. They are also likely to improve the transmission of monetary policy.

- Thrust on greater financial inclusion under the *Pradhan Mantri Jan Dhan Yojana* (PMJDY), under which over 125 million new accounts were opened until end January 2015. The account provides for debit card facility, an overdraft facility (for accounts which are Aadhaar linked), and accidental insurance coverage.
- Public Sector Banks (PSBs) were allowed to reduce the government's shareholding to 52 percent in a phased manner, to help with recapitalization. Important discussion were initiated to improve the functional autonomy of the PSBs, and to improve their governance structure, some of this discussion was modeled on the recommendation of the

[37] The Fourteenth Finance Commission report was tabled during the budget session of the Parliament; we provide a summary of the recommendations made by the Finance Commission separately in Box 3.

PJ Nayak Committee report.

- RBI awarded two new bank licenses; and laid out the norms for payment banks.
- The Central Bank announced a revised regulatory framework with tighter norms for Non-Banking Financial Corporations (NBFCs), bringing it closer to the regulatory framework for commercial banks. Revisions include an increase in minimum capital requirement, tightened rules on deposits and bad loans and stricter corporate governance practices.
- RBI released a framework for revitalizing distressed financial assets to incentivize early identification of problem cases; timely restructuring of accounts which are considered viable; prompt steps by banks for recovery of unviable accounts; higher rates on future borrowings by defaulters.
- NBFCs with a size of INR 5 billion or more will be considered as 'Financial Institutions' in matters related to recovery.
- The commodities market regulator, Forwards Market Commission, will be merged with the regulator of capital markets, Securities and Exchange Board of India to ensure a well regulated commodities market and reduction of wild speculation.
- A new comprehensive law to deal with black money was introduced in the parliament. Under the proposed law, concealment of income and assets and evasion of tax in relation to foreign assets will be prosecutable. To curb domestic black money, a new Benami Transactions (Prohibition) Bill was introduced.
- A Task Force will be created to establish sector-neutral Financial Redressal Agency (FRA) that will address grievances against all financial service providers.

Trade and Capital Market

- RBI relaxed gold import norms, reversing the quantitative restrictions imposed in 2013-2014 to reduce gold imports.
- Increased the limit on individual remittances to $250,000, from $125,000 (and $75,000 before that); restored the limit on Overseas Direct Investment by Corporates to 400 percent of net worth.
- Allowed long-term foreign investors to reinvest their coupons in government bonds even if the limit of US$ 30 bn is utilized.
- Merged different categories of foreign investors, under one head, Registered Foreign Portfolio Investor, in order to simplify the registration process. Allowed portfolio investment in government securities only in dated securities of residual maturity of one year and above; and mandated that all future investment by foreign portfolio investors in the debt market be for a minimum residual maturity of three years to encourage longer maturity flows.
- A new Gold Monetization Scheme will be set up in replacement of the currently existing Gold Deposit and Gold Metal Loan Schemes, which would allow gold depositors to incur interest on their metal account, jewelers to obtain loans and banks and other dealers to monetize gold.
- New gold deposits will be introduced to utilize 20,000 tonnes of available gold stock and sovereign bonds will be introduced as an alternative to purchasing metal.
- Foreign investment will be allowed in Alternative Investment Funds (AIFs), a category of pooled-in investment vehicles for real estate, private equity and hedge funds. To ensure a smooth and integrated process of investment under such investments, the distinction between different categories of foreign investment such as Foreign Portfolio Investors (FPI) and Foreign Direct Investment (FDI) will be eliminated.
- Proposed to amend, through the Finance Bill, Section-6 of FEMA to provide that control on capital flows as equity would be exercised by the Government (in consultation with the RBI).
- A Public Debt Management Agency will be set up to help manage external and domestic debt.

Fiscal

Fiscal reforms spanned the areas of taxes, expenditure, particularly subsidies.

Taxes:

- The pace of reforms to implement Goods and Services Tax (GST) gained momentum. A Constitutional Amendment Bill was introduced in the winter session of the parliament, and is widely expected to be implemented by April 2016.
- The disinvestment Program picked up in December 2014, the government divested 10 percent of its share in Coal India Ltd. and 5 percent in SAIL.
- Corporate tax is proposed to be reduced from 30 percent to 25 percent in a phased manner over the next four years. A phased rationalization and removal of various tax exemptions and incentives will be encouraged beginning next fiscal year to reduce tax disputes and improve administration.
- A tax pass-through will be allowed under category I and II of alternative investments in order to mobilize resources. Additionally, rationalizing of capital gains regime and a pass-through for rental incomes of REITs was proposed.
- Basic Customs duty on certain inputs, raw materials and intermediaries was reduced to minimize the impact of duty aversion.
- Wealth tax will be replaced with a 2 percent surcharge on the super-rich with taxable income of over INR 10 million.
- Educational cess will be subsumed by the Central Excise Duty and be increased to 12.4 percent.
- Service charge plus educational cess will be raised to 14 percent.
- Penalty provisions in indirect taxes will be rationalized to encourage compliance and early dispute resolution.

Expenditure/social expenditure

- The government continued to strive to expand the population that has been provided with a unique biometric based identification, under the *Aadhaar* program, targeting enrollment for 1 billion Indians.
- In order to improve the efficiency of delivery of benefits under the Direct Benefits Transfer Scheme (DBTL), it was merged with the *Pradhan Mantri Jan Dhan Yojana*. The new simplified scheme does not mandate the need of an Adhaar card but simply, a new bank account under the PMJDY.
- The Center commenced the Modified Direct Benefit Transfer Scheme for cooking gas (DBTL) in November. Under the scheme, consumers will receive direct cash subsidy to purchase cooking fuel at market prices; to be directly transferred to their bank accounts. The scheme covered 54 districts in its first phase, and was extended to another 246 districts from January 2015.
- The current DBTL scheme enables cash benefit transfers to the beneficiaries of 35 schemes including cooking gas, the government announced the universalization of the DBT to all schemes and projects that have any component of cash benefits transfer to individual beneficiaries, from levels other than Central.
- Setting up of National Employment Guarantee Fund under consideration under which MGNREGS account holders would directly receive wages in the accounts opened under the PMJDY scheme.
- A panel set up in August, 2014 to restructure the Food Corporation of India, proposed measures to strengthen the distribution of food grains and, plug leakages and reduce the subsidy bill. These include giving the states which do not have provisions of administered purchase prices the responsibility of rice and wheat procurement, presenting direct cash subsidies of INR 3,000 to each beneficiary per year and outsourcing grain storage to private and government agencies. It also suggested a lower coverage of beneficiaries under the food law to 40 percent, down from 67 percent to cover more Below the Poverty Line (BPL) families.
- The government instituted an Expenditure Management Commission to lay out a plan for

rationalizing expenditure. The terms of reference of the Commission included reviewing major areas of central government expenditure and suggest ways of creating fiscal space required to meet developmental expenditure needs without compromising the commitment to fiscal discipline. The interim report of the commission was to be submitted before the budget for 2015-16.

- Authorities increased the Minimum Support Price by a modest 3.7 percent in 2014-15, and off-loaded food stocks.
- Public capital expenditure, esp. on roads, railways and irrigation, expected to increase by 26 percent during 2015-16 (over last year) to 1.7 percent of GDP – in order to support the government vision on infrastructure strengthening. Some of the increase in capital spending to be tempered by further decline in petroleum subsides by 0.3 percent of GDP – on account of discontinuation of subsidies (diesel) on some products and containment of leakages on other (direct benefits transfers rolled out on LPG cylinders).
- Universal social security and pension schemes were unveiled. These include:

1. *Pradhan Mantri Bima Yojana*- An accident insurance for all with an INR 2 lakh (INR 0.2 million) coverage and INR 12 per year premium.
2. *Atal Pension Yojana*- A defined pension to be received after the age of 60 and allocated according to contribution with 50 percent of the contribution to be made by the government for beneficiaries with open accounts before 2030.
3. *Jiwan Bima Yojana*- Insurance with an INR 2 lakh (INR 0.2 million) coverage and INR 330 per year premium with subsidized premiums for BPL card holders, small and marginal farmers and senior citizens.

Energy

- The Government deregulated diesel prices, paving the way for new investments in this sector. It raised gas prices from US$ 4.2 per million BTU to US$ 6.17 (a 33 percent increase), and linking pricing, transparently and automatically, to international prices so as to provide incentives for larger gas supply and thereby relieving the power sector bottlenecks; new "ultra-mega" solar power projects in four states and support to domestic solar panel/wind mill manufacturers.

- Legal guidelines and procedures for allocation of coal mines were laid down. Following the Supreme Court judgment to cancel all but 4 coal mine allocations, the central government promulgated the Coal Mines (Special Provisions) Ordinance, 2014, laying down the procedure for auction of these cancelled coal blocks. The Coal Mines (Special Provision) Bill, 2015 was passed by the Parliament in March, replaced the ordinance.

Infrastructure

- Formation of the National Industrial Corridor Authority and a new institution (3PIndia) to support mainstreaming of PPPs; launch of tax-favorable Infrastructure Investment Trusts; development of 16 new ports, new inland waterways, and new airports in Tier-2 cities; funds for metros in Lucknow and Ahmedabad, and additional funds for railways in border areas.
- An infrastructure investment fund worth INR 200 billion is proposed to be set up to create equity to finance infrastructure projects. Simultaneously, an INR 700 billion of additional investment will be allocated to infrastructure.
- Tax-free bonds will be introduced to help raise equity for roadways, railways and irrigation projects. In similar vein, the PPP model is being revitalized to allow and encourage for greater private sector funding.
- Corporatization of public sector ports and their conversion into companies under the Company's Act will be encouraged to attract investments.
- The introduction of a public Contracts Bill was proposed as a measure to streamline institutional arrangements for resolution of disputes.
- Additionally, a proposal to introduce a regulatory reform bill was made in the Budget

which would bring about cogency of approach across all sectors of infrastructure.
- 5 'Ultra mega' power projects encompassing 4GW each are proposed to be set up in plug and play mode.

Railways Budget

The railway budget proposed to step up its capital expenditure and improve operational efficiency. It also lays out an ambitious plan for expansion in the next five years (INR 8.5 trillion or close to 6 percent of GDP) for expansion. For the current year it has proposed a 50 percent increase in plan expenditure, over the previous year, from 650 to INR 1 trillion in 2015-16; to be financed by a larger budgetary support, own savings, market borrowings as well as institutional investors.

Labor and Land reforms

- An ordinance to amend the Land Acquisition Act, 2014 was cleared by the President to make land acquisition easier in December, 2014. It eased the consent clause and impact assessment requirement for developmental projects related to industrial corridors, PPP projects, rural infrastructure, affordable housing and defense. A bill to regularize the ordinance was passed by Lok Sabha (lower house of the Parliament) on March 10, 2015 but is pending in the Rajya Sabha (upper house of the Parliament).
- Presidential Assent for labor reforms in Rajasthan, setting an example for other States; consolidation of 16 laws to allow single online return; the inspection process made transparent.

Ease of Doing Business reforms

Thrust on improving the business environment continued.
- The Government launched the Make in India campaign in this pursuit to make India a manufacturing hub and accelerate the growth in the manufacturing sector of India, and increase its share in GDP to 25 percent.
- A G2B single-window portal called eBiz with eleven government services such as Employer Registration and Commencement of Business to eliminate the need for procedures and use technology in an integrated manner. Other measures include abolishing requirement of a Certificate of Commencement before the start of operations and replacing it with a simple rule of informing the Registrar of Companies online, creation of a streamlined system which detail all existing procedures and eliminate a human interface to provide clearances within a month. All business and investment clearances on a single online portal with an integrated payment gateway; single window customs clearance.
- Single window clearance for capital intensive steel, coal and power projects.
- A comprehensive bankruptcy code was proposed to be introduced in 2015-16, in line with international standards in order to enhance legal certainty.
- An expert committee will be appointed to examine the possibility of and prepare a draft legislation to replace the need of multiple permissions with a pre-existing regulatory mechanism to expedite the process of permission acquisition.
- The implementation of the General Anti-Avoidance Rules will be deferred by two years, delaying it to beginning of 2017-18. It brings ease to foreign investors who route foreign portfolios through tax havens in a bid to avoid taxes.
- A National Skills Mission will be launched and will consolidate skill initiatives and standardize procedures.
- The budget proposes to create a micro units development refinance agency, Mudra Bank, with a corpus of INR 200 billion and credit guarantee corpus of INR 30 billion in order to provide credit facilities to entrepreneurs with lending priority to SC/ST enterprises. The refinancing of institutions under The Mudra Bank will take place through the Pradhan Mantri Mudra Yojana. According to the Finance Minister currently out of the 57.7 million small business units, 62 percent are owned by SCs, STs and OBCs and The Mudra Bank will facilitate smoother funding for them.

- Setting up of a Self-Employment and Talent Acquisition (SETU) mechanism, a techno-financial, incubation and facilitation program to support start up business, particularly in technology-driven areas. A fund of INR 10 billion is being created under the NITI Aayog for the same.

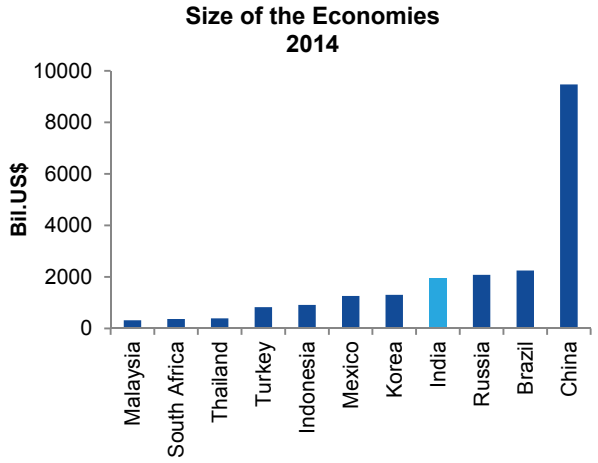
Foreign Direct Investment

FDI cap increased in defense to 49 percent; 100 percent FDI in railway infrastructure; increase in FDI limit to 49 percent from 26 percent (issued as an ordinance). The procedural requirements were eased in 12 sectors, including- telecom, commodities exchange, insurance and petroleum.

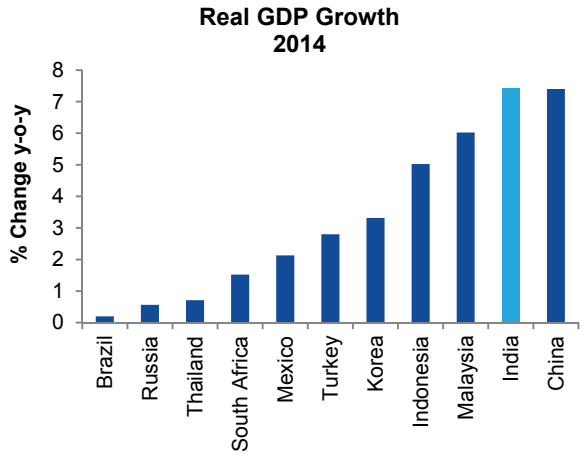
APPENDIX: INDIA ECONOMIC OUTLOOK IN A CROSS COUNTRY PERSPECTIVE

Below we compare India's economic outlook and indicators of macroeconomic strengths and weaknesses with other large emerging markets in 2014. The set of emerging markets include Brazil, China, Indonesia, Malaysia, Mexico, Russia, South Africa, South Korea, Thailand, Turkey, The data is from Haver, unless otherwise indicated, downloaded on March 15, 2015.

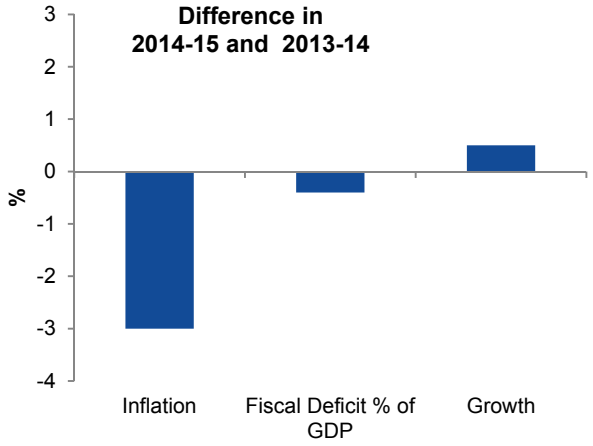
Appendix Figure 1: India is a large economy and…



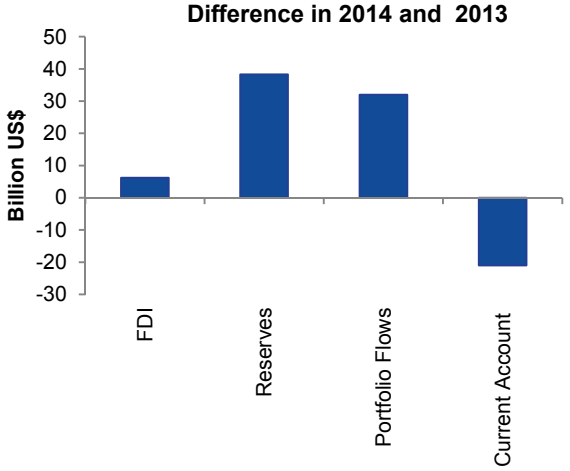
Appendix Figure 2: …One of the fastest growing economy



Appendix Figure 3: Its Macroeconomic Outlook has improved-- Inflation has declined, Fiscal deficit has declined, and growth has accelerated….



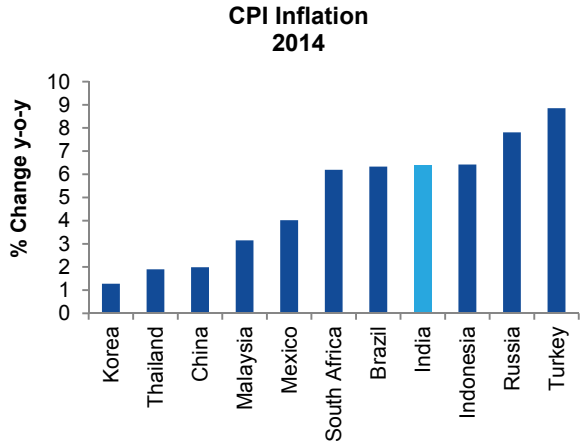
Appendix Figure 4: …and current account deficit has declined, foreign direct and portfolio investment has increased, and accumulation of external reserves has increased



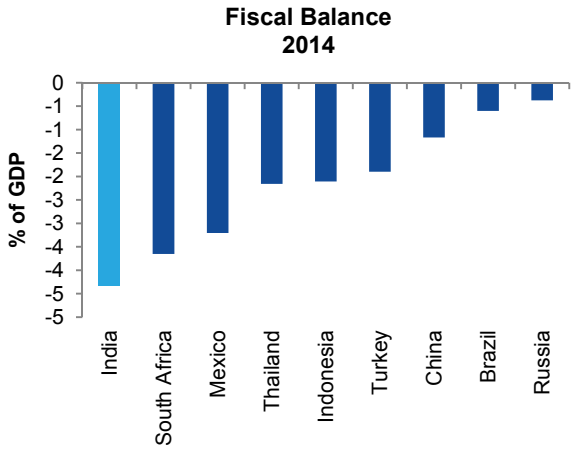
Note: Figure 2, data for 2015 for Turkey, China and Brazil from consensus forecast; calendar years. Figure 3, data for India is from the Reserve Bank of India and the Ministry of Finance. Inflation data for India is for first three quarters of 2014-15; Growth is the estimate for 2014-15 from the CSO. Figure 4 refers to data for calendar year.

However for some of the macro indicators, India's outlook is mixed when compared with other large emerging markets

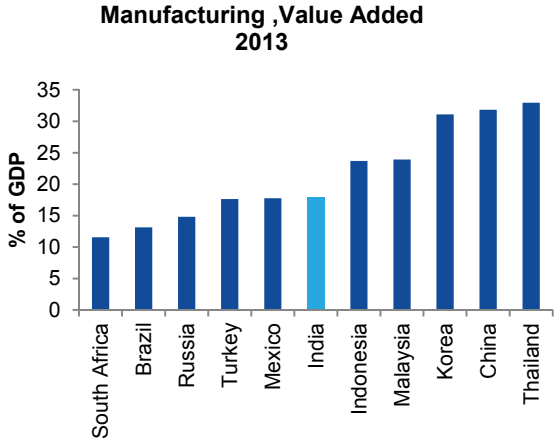
Appendix Figure 5: Inflation is still on the higher side….



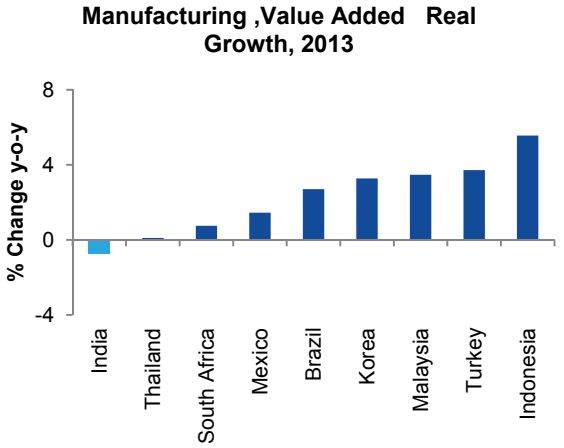
Appendix Figure 6: ….as is the fiscal deficit



Appendix Figure 7: Share of manufacturing in GDP is low…

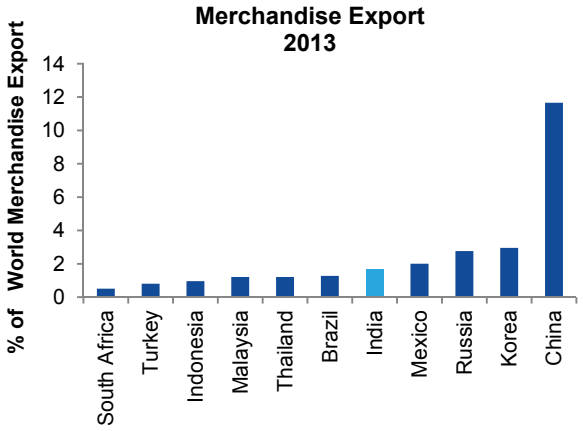


Appendix Figure 8: …and has been growing at a modest rate

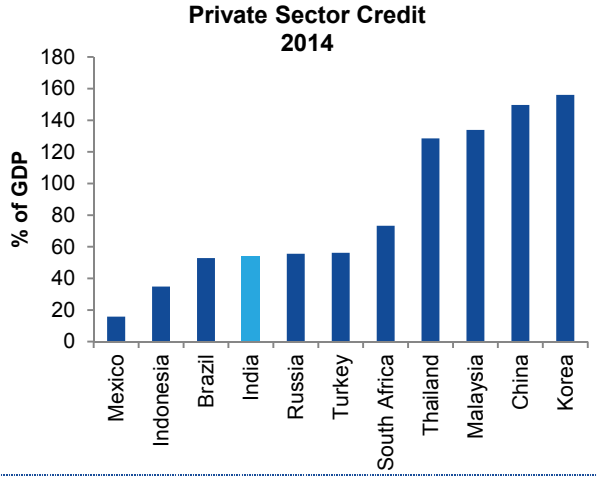


Appendix Figure 9: Exports growth (merchandise) has been slow…

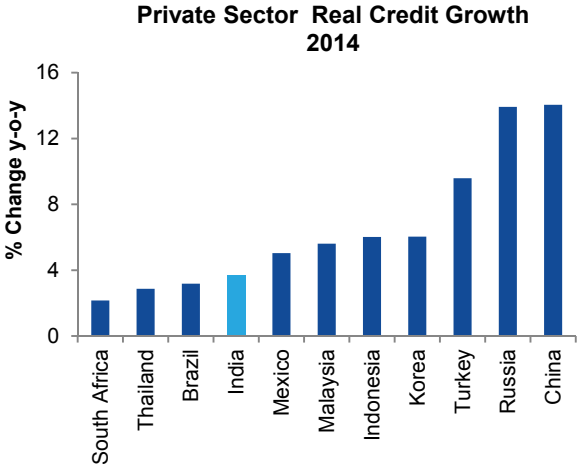
Appendix Figure 10: ….and its share in World Exports is low



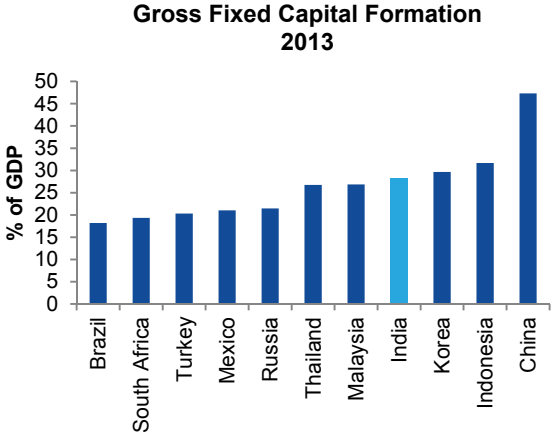
Appendix Figure 11: Credit to GDP ratio has been low…



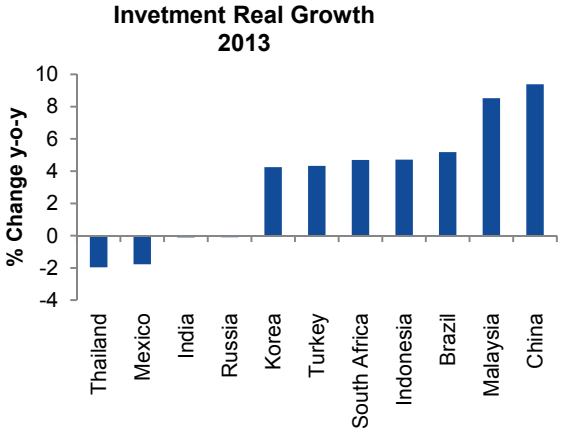
Appendix Figure 12: ….and has been growing slowly



Appendix Figure 13: Rate of Investment is comparable….



Appendix Figure 14: ….but has been growing slowly



Appendix Table 1: Selected Economic Indicators

	Average 2006-2010	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
					Proj.	Proj.	Proj.	Proj.
Real Income and Prices (% change)								
GDP, market prices	*8.3*	*6.6*	5.1	6.9	7.2	7.5	7.9	8.0
Private Consumption	*8.2*	*9.3*	5.5	6.2	6.1	7.4	8.5	8.9
Government Consumption	*8.7*	*6.9*	1.7	8.2	8.6	8.7	8	7.5
Gross Fixed Investment	*10.4*	*12.3*	-0.3	3.0	4	9.0	12.0	13.0
Exports, GNFS	*11.2*	*15.6*	6.7	7.3	0.5	6.3	7.5	7.5
Imports, GNFS	*13.6*	*21.1*	6.0	-8.4	-0.4	9.1	13.0	15.0
GDP, factor cost	*8.6*	*6.7*	4.9	6.6	7.1	7.5	7.9	8.1
Agriculture	*3.9*	*5.0*	1.7	3.8	1.2	2.1	2.8	2.8
Industry	*8.6*	*7.8*	2.3	4.4	5.0	5.5	6.1	6.4
Services	*10.1*	*6.6*	8.0	9.1	10.6	10.5	10.5	10.5
GDP Deflator, market prices	*7.2*	*8.5*	7.6	6.2	5.9	6.1	5.2	4.9
Consumption, Investment and Savings (% of GDP)								
Consumption	*68.1*	68.8	69.8	71.0	71.9	72.5	73.5	74.2
Investment 1/	*31.8*	33.6	31.4	29.7	28.8	29.2	30.6	32.0
Gross Savings	*34.2*	33.9	31.8	30.6	..	..	..	..
External Sector								
Current Account Balance (% of GDP)	*-2.0*	-4.3	-4.8	-1.7	-0.7	-0.9	-1.7	-2.7
General Government Finances (% of GDP)								
Deficit 2/	*6.9*	-7.8	-7.2	-6.8	-6.7	-6.1	-5.6	-4.7
Total Debt	*71.3*	68.3	67.7	66.8	64.8	62.7	60.7	58.5

Note:
All figures in *Italics* are based on the old GDP series (2004-05 base)
1/ Gross fixed capital formation
2/ Inclusive of receipts from 3G spectrum auctions and disinvestment
Sources: Central Statistical Office, Reserve Bank of India, and World Bank Staff Estimates.

Appendix Table 2: Central Government Finances

(percent of GDP)	Average 2006-2010	2011-12	2012-13	2013-14	2014-15 (BE)	2014-15 (RE)	2015-16 (BE)
Total Revenue and Grants	***10.2***	**8.7**	**9.1**	**9.2**	**9.7**	**9.1**	**8.6**
Net Tax Revenue	*7.8*	7.1	7.4	7.2	7.6	7.2	6.5
Gross Tax Revenue	*10.7*	10.1	10.4	10.0	10.6	9.9	10.3
Corporate Tax	*3.7*	3.7	3.6	3.5	3.5	3.4	3.3
Taxes on Income	*1.9*	1.9	2.0	2.1	2.2	2.2	2.3
Excise Tax	*2.1*	1.6	1.8	1.5	1.6	1.5	1.6
Service Tax	*1.0*	1.1	1.3	1.4	1.7	1.3	1.5
Customs Duties	*1.8*	1.7	1.7	1.5	1.6	1.5	1.5
Less: States' share	*2.8*	2.9	2.9	2.8	3.0	2.7	3.7
Non Tax Revenue 1/	*2.1*	1.4	1.4	1.8	1.6	1.7	1.6
Non-Debt Capital Receipts	*0.3*	0.2	0.3	0.3	0.5	0.2	0.5
Total Expenditure and Net Lending	***14.8***	**14.6**	**14.0**	**13.6**	**13.8**	**13.2**	**12.5**
Current Expenditure	*13.1*	13.0	12.4	12.1	12.2	11.8	10.9
Interest Payments	*3.3*	3.1	3.1	3.3	3.3	3.3	3.2
Subsidies	*1.9*	2.5	2.6	2.2	2.0	2.1	1.7
o/w Petroleum	*0.2*	0.8	1.0	0.8	0.5	0.5	0.2
Capital Expenditure and Net Lending	*1.7*	1.6	1.5	1.5	1.7	1.4	1.6
Recovery of loans	*0.1*	0.2	0.2	0.1	0.1	0.1	0.1
Capital Spending	*1.9*	1.8	1.7	1.7	1.8	1.5	1.7
Gross Fiscal Deficit (GoI defn)	***4.6***	**5.8**	**4.9**	**4.4**	**4.1**	**4.1**	**3.9**
Memo items							
Disinvestment	*0.3*	0.2	0.3	0.3	0.5	0.2	0.5
Gross Fiscal Deficit (WB defn)	*5.2*	6.0	5.2	4.7	4.6	4.3	4.4
Primary Deficit (GoI defn)	*1.3*	2.7	1.8	1.1	0.8	0.8	0.7
Primary Deficit (WB defn)	*1.9*	3.0	2.0	1.4	1.3	1.0	1.2
Central Government Debt (incl external debt) 2/	*54.8*	46.1	46.1	46.0	45.4	46.8	46.1

Source: Ministry of Finance
Note: 1/ Includes revenues from spectrum auctions
2/ Does not include part of NSSF and MSS liabilities not used for financing Central government debt
All figures in *Italics* are based on the old GDP series (2004-05 base)

Appendix Table 3: Development Indicators

Indicator	2000	2005	2010	2011	2012
Demographics					
Population (millions)	1042.3	1127.1	1205.6	1221.2	1236.7
Poverty and Income Distribution					
Poverty $1.25/day PPP, headcount ratio percent	..	41.6	32.7	..	23.6
Poverty $2/day PPP, headcount ratio percent	..	75.6	68.8	..	59.2
National Poverty Estimates, headcount ratio percent	..	37.2	29.8	..	21.9
Gini Coefficient	..	33.4	33.9	..	33.6
Labor					
Labor force participation rate, total	58.6	60.4	54.8	..	53.4
Labor force participation rate, female	34.1	37.3	29.0	..	27.2
Labor force participation rate, male	82.3	82.9	79.7	..	78.8
Unemployment, total	4.3	4.4	3.5	..	3.6
Health					
Infant Mortality Rate (per '000 live births)	68.0	58.0	47.0	44.0	42.0
Education					
Lower Secondary gross enrolment rate (%)		52.2	65.2	66.6	..
Senior Secondary gross enrolment rate (%)		28.5	39.4	45.9	..
Tertiary gross enrolment rate (%)		..	19.4	20.8	21.1

Sources: WDI, CEIC, and World Bank staff estimates. The table reflects closest data available for stated years. Poverty rates are for the 2004-05, 2009-10 and 2011-12 periods.

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