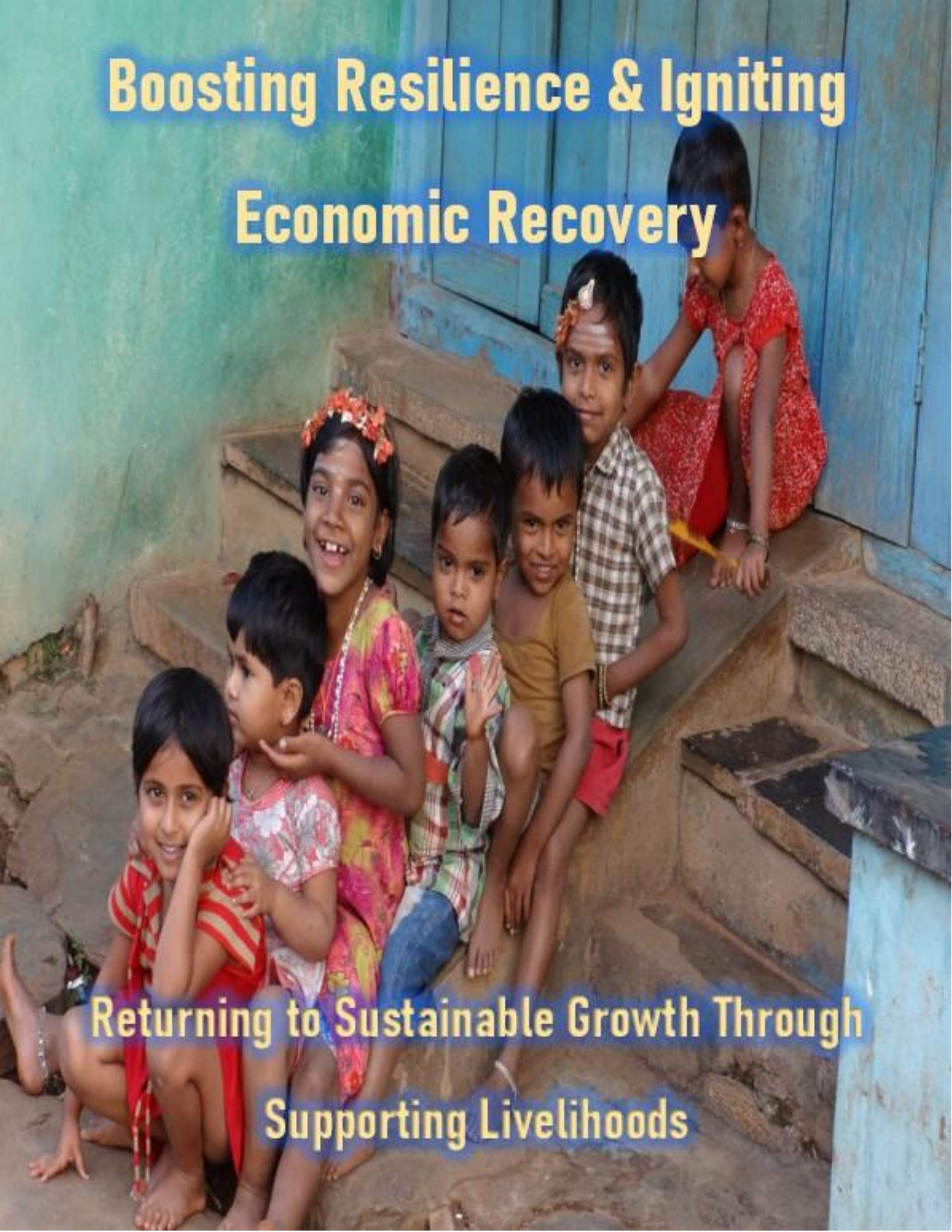
Boosting Resilience & Igniting Economic Recovery



Returning to Sustainable Growth Through Supporting Livelihoods

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To All the Indians

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This write up is in the back drop of the unprecedented hazardous scenarios prevailing all across the globe due to the pandemic called COVID19. It started in Wuhan, China around the last few days of December, 2019. Today, the 30th Day of April, 2020, about four months from the DAY ZERO, it has infected over 3.2 million across the globe claiming almost 230,000 human lives. All skins, all religions, all languages, all ethnicities….no one is spared. This probably should draw our attention that at the end of the day we all belong to one single race called HUMANs. All our imaginary divisions in forms of race, sex, ethnicity, religion, language, culture and boundaries holds no meaning and stands insignificant in front of the forces of the nature which we often choose to disregard in the name of the madness we coined as development & prosperity.

Having said that, this is not an attempt to go philosophical about life, start self-introspection or rethink and restructure the way of life. This one is purely of economic interests. My intention here is to limit the thoughts within the periphery of different aspects of economy at large.

This is not a news feed of the regular social media platforms and thus, there will be some nos with words. Less panic and more understanding. By no means, I would like to add on to the panic that has already set in taking the whole planet under its grasp. There will be no political or religious views. No mindless criticism of the Governments, be it any state or center. They are possibly already doing whatever they can and it's not the time to find faults rather this is the time to join hands.

First and foremost, one can and should at least follow the instruction being issued time to time. We can help saving the nation by only adhering to the govt. directives. Remember, if we step back and don't get ourselves infected then we also stop the virus from infecting hundreds of others using us as a weapon. All we need to do at this moment is to Stay home, stay safe & calm down…this is no way the end of the world. All we need to do is just stay put and break the chain.

My one and only intention here is to think of the possible ways to boost resilience in the livelihood of millions of Indians at stress & kick-start recovery, both Economic as well as Social. I invite you all to think with me, with your imagination, about the possible ways and means which can bring the lost livelihood back to the hundreds of millions fellow citizens who are under tremendous stress as we read this now and on the verge of falling back to poverty in absence of timely, adequate & meaningful actions from the establishments & society at large. Let's think through…together……!!

** Observations

Crude, Import Bill, CAD & Inflation

According to oil ministry's Petroleum Planning and Analysis Cell (PPAC), country's oil imports is projected to fall to 225 million tons (mt) in FY20 against 227 mt in FY19 while the import bill would reduce 6% to $105 billion from $112 billion worth of imports in previous fiscal.

Base was taken as $64/bl & USD@ INR 71

The result of A dollar fall in crude oil price in reducing country's oil import bill is estimated by almost Rs 2,900 crore while a rupee fall in value of currency against dollar results in increased spending by upto Rs 2,700 crore.

(Source: Economictimes_Mar 09)

INR @77-78 will nullify much of the savings upto $57-58/bl, below that it's a straight saving.

Demand fall would be much deeper than estimated 0.09%

Global trend of demand loss

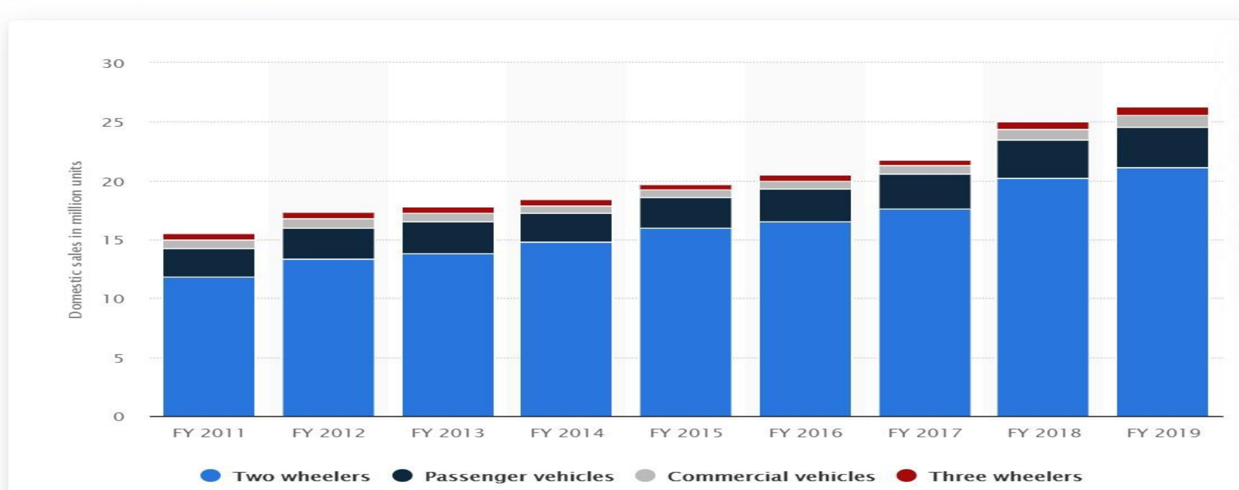
Earlier estimation: 95 mb/day

Revised estimation: Demand loss of 9.3 mb/d yoy in 2020 which is more than 10%, again a very conservative & deceptive projection. Reality could be somewhere between 20-25%.

India's demand & import should also see the similar dip of over 20 %, even if govt is planning to increase crude reserve under ISPR phase II, storage capacity is simply not sufficient (39MT against 550MT of China or 520MT of Japan) to keep the imports on and take advantage of the low crude price. While new capacity may not be added any time before 5-7 years, if they start now.

Demand loss is real, at least in the short to medium term. For instance, just think of the car sales of the country. Consider the fuel consumptions of these 25 million vehicles that was supposed to get added to the natural demand. Expect about 20% drop in the automobile sales in FY21 and so for the fuel consumptions by the new vehicles. There could be hundreds of similar situations.

(in million units)



Source: Statista.com

***** Net off all the factors there could be a drop in excess of $70 billion in India's oil import bill.***

India may end with a positive current account of about $ 20 billion as suggested by some of the experts.

** Recommendation_Strategic-Energy Security

Covering the storage deficiency with Crude-Call-Option (CCO)

One way of covering up this deficiency could be entering into ***forward contract with the major import partners who may have a fiscal pressure due to low crude price like UAE, KSA & IRAN at a well negotiated strike price.*** *Iraq could be a review case due to the possible political unrest in case of a prolonged revenue loss.*

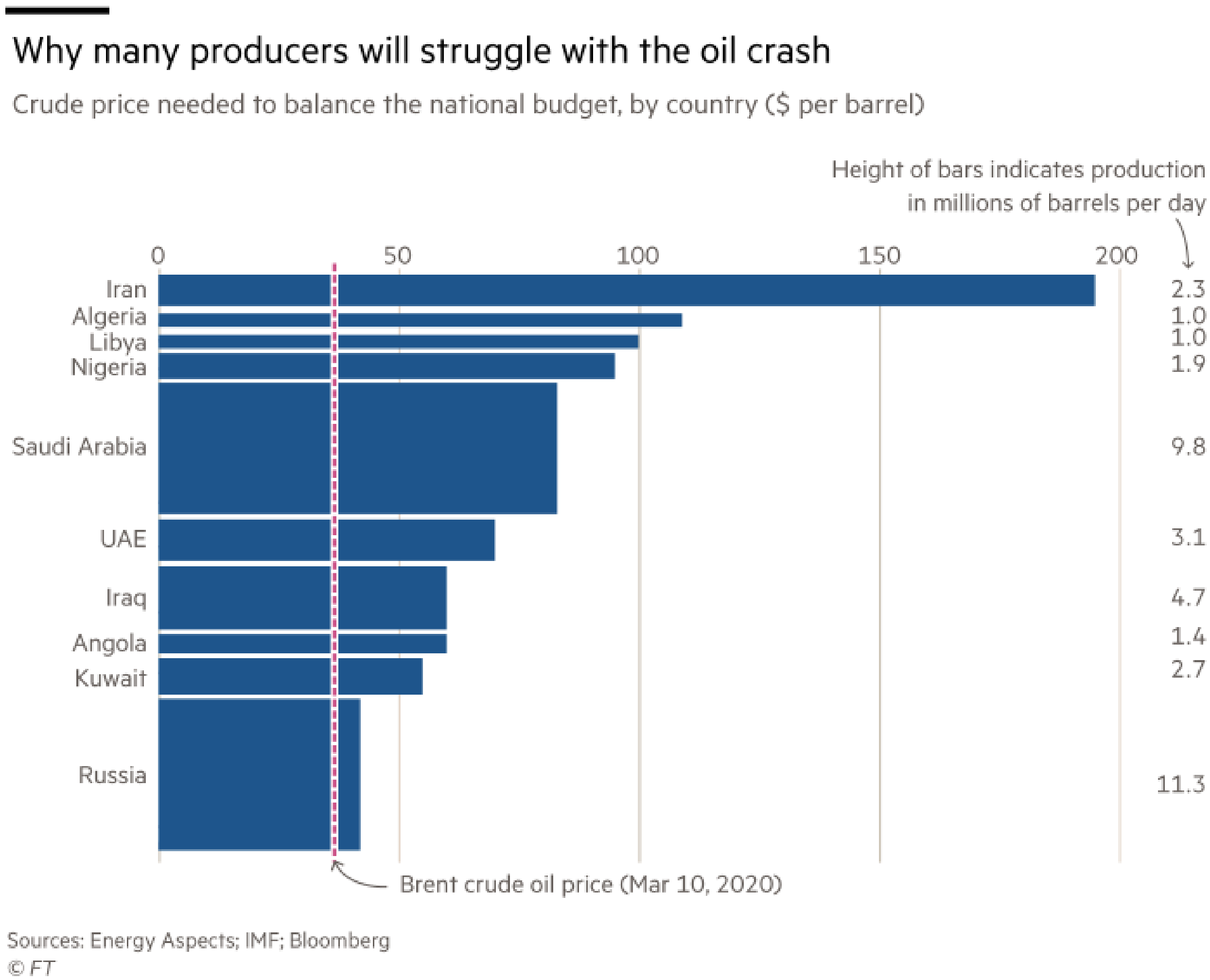
Though most of these nations are pretty wealthy but at the same time most of their sovereign wealth must be already invested somewhere and would probably not be easy to liquidate considering the weak and deteriorating global investors' sentiment.

So, in situations like continued low crude price, some of them may see pressure mounting on their current accounts. Receiving an option

premium upfront may not look a bad choice at their end considering there is no surety and timeline for recovery of crude demand.

By the time crude demand recovers, a big chunk of US shell suppliers will be out of business, allowing the OPEK+ to ramp up their quota to fill in the short supply from Texas. So, selling some of their future production at a discounted price can actually be a workable solution for them to receive few billions of option premium to improve the cash flow.

It makes sense for them too:



The above figure shows the price per barrel required by each of these producers to balance their national budget. Sustained crude price below that level would mean that they may need to deep into their reserves to keep the country running, considering most of the OPEC economies' dependence on Govt investments and spending. For instance, GCC economies are expected to have a fiscal deficit of around $140bn for this year.

Let's take a closer look at the table which shows the estimated fiscal and production (US-Shale) break-even for some of the major oil import partners of India.

Country	Fiscal Break-even($/bl)
Iran	195
Russia	42
UAE	70
KSA	83
US-Shale	48-54

Source (other than US Shale) : https://knoema.com/ US-Shale is production break-even

On the other side, India has created a decent buffer on the forex reserve front over a period of time, which now is hovering around $470bn and can surely afford to pay a few billions in advance to secure the future supply at much comfortable rate.

For instance, if the negotiated price is $30/barrel, $28.5 would become the strike price & $1.5(@5%) would become the option premium. For a future supply of say, 500MT (100MT*next 5 years) it's a cool $5.5 bio of immediate cash flow for the writer and 5 yrs. of secured supply at comfortable price for buyer. Win-win.

Qty	Negotiated Price ($)	Strike Price ($)	Premium ($)
Barrel	30	28.5	1.5
500 MT	110bn	104.5bn	5.5bn

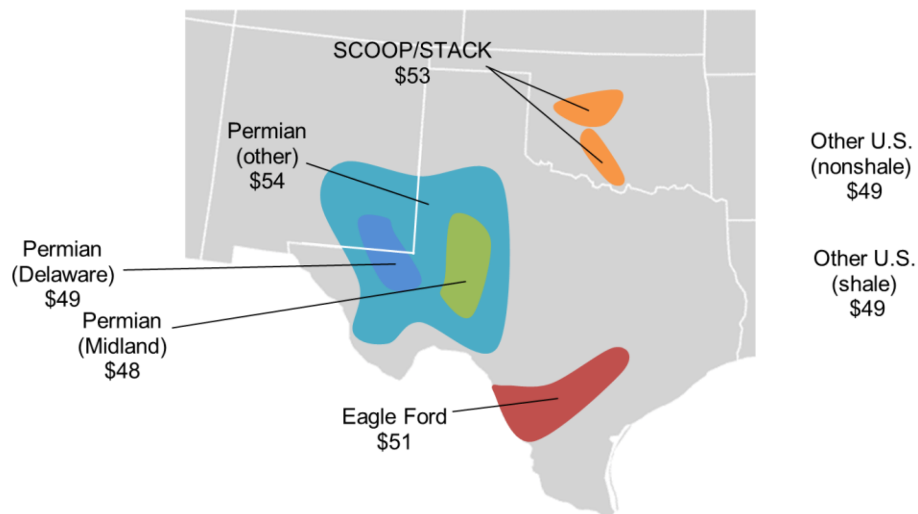
Figures are just for illustration & not exact

This sale of 100MT of future production won't affect the future oil revenues of the writer much as they will have an incremental quota for production when normalcy restores. As per a recent report in in a prominent US news agency:

" The breakeven price for the U.S. shale industry lies in the $48 to $54 per barrel range.

The industry is heavily indebted, and companies will not be able to service the debt with the lower oil price."

Chart 1
Average Breakeven Prices in U.S. Range from $48 to $54 per Barrel



NOTES: In the March 2019 Dallas Fed Energy Survey, executives from 82 exploration and production firms answered the question, "In the top two areas in which your firm is active: What WTI oil price does your firm need to profitably drill a new well?" The survey collection period was March 13–21. WTI refers to West Texas Intermediate crude oil.
SOURCES: Energy Information Administration, Federal Reserve Bank of Dallas.

Source: cnn.com

The US-Shale industry is highly leveraged with unsustainable Debt to Equity ratio. In scenarios like WTI below $40 for more than 2-3 months will drive most of them filing for bankruptcy and will be out of business. They do not seem to be prepared to survive the forced *'Shut-Ins'*. Therefore, in all probabilities the lost production of US-Shale may not return to the market anytime soon opening up the doors for increased production from OPEC+.

Now, super impose the scenario on India's pre COVID crude import of 225MT/year. Even if the lost demand is somehow restored sooner than later and Brent settles back say at $60 by mid of FY21, the net effect of such an option would be a whopping 50% reduction in oil import bill, which alone accounts for almost 20% of the total import bill of the country, thus narrowing down the trade as well as current account deficit which can be contained well below 1% of GDP thus creating room for new monetary approach of QE without skyrocketing the inflation, CPI specifically.

We should start a dialogue with UAE, KSA & IRAN specifically for this contract as the GCC and other middle east countries are heavily dependent on Govt spending to keep their economy rolling and right at this moment they are running a risk of huge fiscal deficits for the first time in the recent past. The damage is so severe that some of them may have to dip into their reserves just to stay afloat. Iraq, though a major partner for the crude import in the normal scenario, should be avoided at this moment, since prolonged low crude can end up creating another political mess in the country raising serious concerns on the Govt's capacity to honour any oil trade contract in coming future. Russia is reasonably better placed and may be willing to wait for a demand & price recovery. US shale is not a candidate since their primary concern is to manage the present inventory situation and half of them may not be in business to serve the contract obligation even after a year from now.

** Recommendation_Recovery Focus

Currency as a commodity (CAAC)

Ultra-Short-Term measures: Immediate to 30 days

- While for the end user currency will continue to be a legal tender, from the supplier's (Govt) side it should be treated as an essential commodity.

- As an essential commodity, it should be supplied more when required.

- Create new money. There will be multiplying effects. One simple way of measuring the effect is:

  $MF = NM^{(1/rr)}$

  Where MF=Multiplying effect, NM= New Money, rr=Reserve Requirement

  So, decide the intended impact and create new money accordingly. For instance, if the reserve requirement is 5%, the multiplier effect would be 20X.

- RBI can supply more money maintaining the same 200(195 to be exact) crores Gold reserve.

  As per section 33 (2) of RBI ACT 1934

  "The aggregate value of Gold Coin, Bullion, and foreign securities held as assets and the aggregate value of Gold Coin and Bullion so held shall not at any time be less than two hundred crores of rupees and one hundred and fifteen crores of rupees respectively "

- ***Money has to be supplied also as income & not only as loan.***

- Crete money, supply it to revive consumptions, it will have its chain effect and real output will catch up. We have enough buffer of reserve and inflation side.

- Circulate the new money through NREGS & UPEGS (Urban poor Employment Guarantee Scheme, Connect with SBM (Swachh Bharat Mission).

- Pay rural poor to build rural infrastructure

- Pay urban poor for cleaning up (Fetch budget from SBM) and sterilization drive. Does not matter. Just give them some meaningful work & pay them.

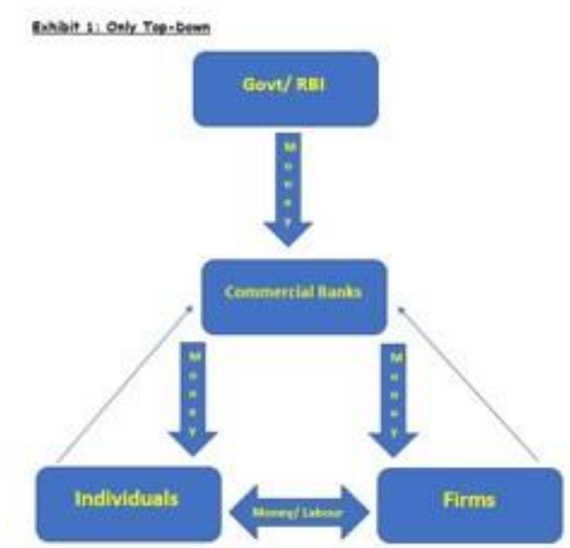
- Supplying liquidity to the banks and hoping they would lend is not going to work easily because banks are not sure of income sustainability of the borrowers in retail. Same is to be read as the capability to generate operating revenue when it comes to the firms.

On the other hand, supplying money to support livelihood of 300mn people can have the desired effect of increased demand and increased output of essential products first and secondary or good to have products as a chain reaction. If the manufacturers can return to their full capacity utilization, it would mean employment security for other hundreds of millions & the effects will spread into the other relatively high-end products. Slowly but surely.

- For example, if someone is paid under NREGS/UPEGS, they will spend the money to buy foods, clothes or medicines. The retailer of the food, clothes or medicine will buy the same items and some additional items like foot wares, DTH subscription or may be some beverages. The foot ware, beverage and DTH company can continue their operations and pay their employees on time. Those employees, in millions are going to buy their necessities and also pay their EMIs…. & so on.

- Without back up support for generating income or restoring the basic consumption cycle, only supplying money to the banks and asking them to lend will not have much effects. Banks will simply put the money into treasury operations creating some bubbles in the financial instruments.

Top-Down needs to be supported by Bottom-Up



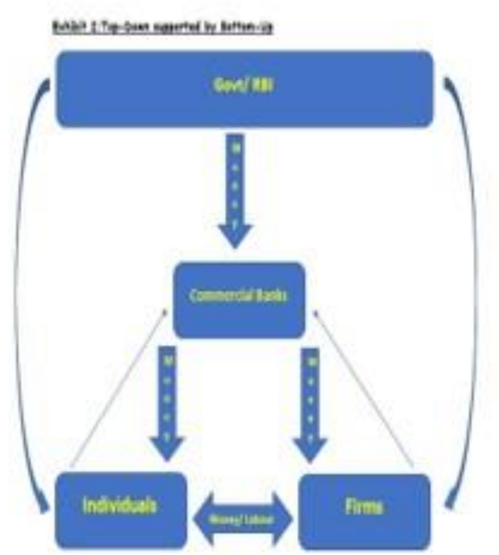


Exhibit 1: Only Top-Down

Govt (RBI) supplies money to commercial banks. Commercial banks lend the money to Individuals & Firms. Individuals & Firms are expected to pay back with interests. This paying back is highly likely to get disrupted given the income loss due to Lockdown resulting in decreased economic activities. Without supporting the bottom end only pushing the money down will end up in soaring NPAs, this time in consumer segments too.

Exhibit 2: Top-Down supported by Bottom-Up

In this approach, Govt supports the bottom end with DBT (Direct Benefit Transfer) in forms to paid employments and EMI subsidy. It is done on regular intervals as farm loan waivers without any long-term effect, Govt should consider to include the consumers & MSM business owners this time. It will help in reactivating the consumption eco-system.

- There would be inflationary pressure, but impact of that can be moderated.

- Impact of inflation can be moderated with additional supplies of essentials and scaled up outputs. The low crude price will have additional cooling effect.

- The figures below are self-explanatory;

Money Supply without output growth

number of widgets	Money supply	average price	inflation rate
20,000	10,000	0.5	
20,000	20,000	1	**100%**
20,000	40,000	2	**100%**
20,000	80,000	4	**100%**
20,000	100,000	5	**100%**

Money supply with output growth

number of widgets	Money supply	average price	inflation rate
20,000	10,000	0.5	
24,000	12,000	0.5	**0%**
28,000	14,000	0.5	**0%**
32,000	20,000	0.625	**25%**
36,000	30,000	0.833	**33%**

Source: Economicshelp.org

- There will be less chance of cost-push as the price of labour is not going to increase for some time now, neither the other input costs like raw materials etc. are expected to see any big spike in coming future. Rather prolonged dip in crude can actually spread into other core commodities.

- Lower, Middle class and Senior Citizens also need to be shielded from upward inflationary pressure due to this additional supply of money, though judicious distribution of essential supplies and income protection. Interest on Senior Citizen deposits (may be roofed with present base) needs to be linked with CPI and to be floored at CPI+ safety spread. To be supported if required.

** Recommendation_Inflation Focus

Introduction of Temporary Concentrated Consumer Price Index (TC-CPI)

Medium Term Measure: 6-12 Months

- Create new Temporary Concentrated CPI
- Keep only MUST HAVEs & Exclude all GOOD TO HAVEs.
- Increase weightage of MUST HAVEs
- Aim for "0%" inflation in Food, Health & Housing. Overall TC-CPI inflation should be aimed between 0-1%.
- Use buffer stocks available with FCI, they have enough of it.
- This is just a temporary arrangement may be for next 6-12 months
- Old CPI can be restored once the economic downturn due to COVID 19 is nullified to a great extent & economy is back on the growth track of better than emerging market basket average.
- This will help Govt to set clear priorities during the crisis period.
- Any exclusion does not mean that there will be hyper-inflation. Price of those items can still be subject to regular inflation. Just that those will not be accounted for while targeting 0-1% inflation in overall TC-CPI for next 6-12 months.

This is how the current basket of CPI looks like. Items marketed in red can be dropped temporarily setting a clear goal for Govt to ease the burden of the common people in the areas where it would matter the most.

CPI

(Base 2012=100)		
Cereals and products		9.67
Meat and Fish		3.61
Egg		0.43
Milk and products		6.61
Oils and fats		3.56
Fruits		2.89
Vegetables		6.04
Pulses and products		2.38
Sugar and confectionery		1.36
Spices		2.5
Non-alcoholic beverages		**1.26**
Prepared meals, snacks, sweets etc.		**5.55**
PAN, TOBACCO AND INTOXICANTS		**2.38**
Clothing		**5.58**
Footwear		**0.95**
HOUSING		10.07
FUEL AND LIGHT		6.84
Household goods and services		3.8
Health		5.89
Transport and communication		8.59
Recreation and amusement		**1.68**
Education		4.46
Personal care and effects		3.89

Source: MOSPI

This is how the TC-CPI would look like. More Concentrated with more weightage on essentials & areas where lower or no inflation would be a big relief for the common people. Items highlighted in green have been given an improved weightage. No of items down to 17 from 23.

Just wondering what were the items like PAN-Tobacco-Intoxicants or Amusement doing there anyway. Why should the Govt even be tracking the retail prices of intoxicants?

TC-CPI

(Base 2012=100)	
Cereals and products	**12**
Meat and Fish	**5.00**
Egg	**1.00**
Milk and products	6.61
Oils and fats	3.56
Fruits	**3.00**
Vegetables	8.00
Pulses and products	2.38
Sugar and confectionery	1.36
Spices	2.5
HOUSING	10.07
FUEL AND LIGHT	**7.72**
Household goods and services	3.8
Health	**10**
Transport and communication	**10**
Education	**8**
Personal care and effects	**5.00**

TC-CPI - Addl. Supportive measures

- Issue temporary digital ration cards to all those applications on hold & include in PDS for next 3-6 months.

- To create **M.G.Zs (Mandatory Green Zones)** in all the districts contributing significantly to the agricultural outputs. Treat them as important as COVID HOTSPOTS, even if some of them are not, to make sure there are no disruption in Sowing of Kharif or even Zaid Ravi for that matter. For instance, West Bengal accounts for almost 20% of country's rice production. Any mishaps in the districts like Burdwan, 24 Parganas or Medinipur can have a serious implication on the overall Kharif outputs of the country. Similarly, some strategically important districts from Punjab, Uttar-Pradesh, Tamilnadu, Andhra Pradesh or Bihar needs to be identified and treated with utmost care to keep them clean, up and running for the coming season. While we utilize the excess reserves available with FCI in case of emergencies like the prevailing one, we should make sure that we fill in the capacity with the next season's production for the similar exigencies.

- This virus is going to stay here for some time and a second wave around the fall this year may not be a farfetched nightmare.

** Recommendation_Banking, Liquidity & Credit Growth

Introducing temporary DR3-NA2 framework

Incentivizing Banks to maintain and increase their exposures in MSME, Other Priority Sector, MFIs and HFCs, with special focus to MSME through Differentiated Reverse Repo Rate (DR3) based on Net Added Advance (NA2) to the MSME sector.

- Banking to economy is blood circulation to a human body. Banking sector channelize and converts national savings into investments through credit and thus play an immensely important role in business, employment and overall economic growth of a country, including ours. Without a robust and highly efficient banking system no economy can thrive.

- However, banking is one of those core areas where any kind of shock arriving out of real economy gets spread very quickly. The pandemic, lockdown and the economic aftershocks have already hit the country as we discuss. In no time it will start surfacing and will take an ugly turn towards almost zero to negative economic growth following the global trend. It's a given, no escape. With no exception, banking is also going to get hit very hard, with soaring NPAs from all segments of the asset basket. The perceived safe bet of retail lending may come out be not so safe anymore with millions of individual borrowers losing their income partially or completely. MSME is going to be another pain area with all Mom n Dad shops falling down with a frozen balance sheet.

- Indeed, it's a tremendously challenging time ahead for the Indian banking sector which had already been struggling for some time to keep their bad loans under check. Add to that the mounting pressure to increase credit growth, especially to the targeted sectors to support the economy at this moment of crisis.

- Let's take a look at the present guidelines on the Priority Sector Lending (PSL) for the commercial banks. There are several categories which comes under PSL;

Sl	Categories
1	Agriculture
2	Micro, Small and Medium Enterprises
3	Export Credit
4	Education
5	Housing
6	Social Infrastructure
7	Renewable Energy
8	Others

- RBI has set specific PSL targets for the commercial banks as a percentage of their total credit;

Categories	Domestic scheduled commercial banks (excluding Regional Rural Banks and Small Finance Banks) and Foreign banks with 20 branches and above	Foreign banks with less than 20 branches
Total Priority Sector	40 per cent of Adjusted Net Bank Credit or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher.	40 per cent of Adjusted Net Bank Credit or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher, to be achieved in a phased manner by 2020.
Agriculture #	18 per cent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher. Within the 18 percent target for agriculture, a target of 8 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher is prescribed for Small and Marginal Farmers.	Not applicable
Micro Enterprises	7.5 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher.	Not applicable
Advances to Weaker Sections	10 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher	Not applicable

Faster recovery in MSME Should become one of the key focus areas looking at the roles they play in employment generation and export.

The Indian MSME sector is the backbone of the national economic structure and has unremittingly acted as the bulwark for the Indian economy, providing it resilience to ward off global economic shocks and adversities. With around 63.4 million units throughout the geographical expanse of the country, MSMEs contribute around 6.11% of the manufacturing GDP and 24.63% of the GDP from service activities as well as 33.4% of India's manufacturing output. **They have been able to provide employment to around 120 million persons and contribute around 45% of the overall exports from India.** The sector has consistently maintained a growth rate of over 10%. About 20% of the MSMEs are based out of rural areas, which indicates the deployment of significant rural workforce in the MSME sector and is an exhibit to the importance of these enterprises in promoting sustainable and inclusive development as well as generating large scale employment, especially in the rural areas.

Source: CII

- They are adding about 15 million jobs every year as per the CII survey data on May, 2019.
- The overall PSL target needs to be increased slightly may be to 42.5% from the current 40% to accommodate MSME target of 10%.
- Focused Borrower Group' (FBG) needs to be created within the MSME sector to keep the NPA under check. Here are few shortlisting parameters, there could be hundreds more:

  ** MSMEs which had made profits in last 3 FY

  ** Units which had positive net cash flow for last 3 FY

  ** Units which employs more than 20 employees

  And so on……………..These criteria are to be adjusted in accordance with the overall target.

** Some adjustments can be made in the risk weightage assigned to different assets/investments or the methods of calculation to free up more capital especially for MSME/Housing and to set up the ground for liquidity push in the sectors. Here are some possibilities:

Risk Weightage-Deposits & Investments	RW	Modified RW
Deposits placed with SIDBI/NABARD/NHB in lieu of shortfall in lending to priority sector. 100	100	125

Risk Weightage-Loans			
Category of Loan	**LTV Ratio (%)**	**RW**	**Modified RW**
(a) Individual Housing Loans			
(i) Up to Rs. 20 lakhs	90	50	25
(ii) Above Rs. 20 lakh and up to Rs. 75 lakhs	80	50	25
(iii) Above Rs.75 lakh	75	75	50
(b) Commercial Real Estate – Residential Housing (CRE-RH)	NA	75	
CRE-RH-Affordable	NA	75	50
CRE-RH-Luxury	NA	75	75
(c) Commercial Real Estate (CRE)	NA	100	100
Fund Based Exposure to Commercial Real Estate Residential Housing (CRE-RH)	NA	75	
FBE to CRERH-A	NA	75	50

Micro and Small Enterprises (MSE) Advances Guaranteed by Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) up to the guaranteed portion. Note: Banks may assign zero risk weight for the guaranteed portion. The balance outstanding in excess of the guaranteed portion would attract a risk-weight as appropriate to the counterparty. Two illustrative examples are given in Annex 10.1.	NA	0	0' for full unsecured portion or outstanding, whichever is higher.

NPA purchased from other banks	NA	100	150

Source-existing weightage & guidelines for calculation : https://rbidocs.rbi.org.in/rdocs/content/pdfs/86BS010715F_A9.pdf

- Banks' exposure to Fourth (currently third) dwelling unit onwards to an individual can be treated as CRE exposures.
- Balance in the current accounts with other banks which is currently weighted at 20 can also be revised to 50CRE-RH can be divided into sub-categories housing-**Affordable (CRE-RH-A)** Or **Luxury (CRE-RH-L)** with a lower risk weightage for CRE-RH-A, to push affordable housing.

Once the ground is set, the final adjustments can be made in the way the apex bank offers rates to the commercial banks to encourage the banks to lend more to the Priority Sectors, specifically to MSME & Housing.

- *Cold response to TLTRO 2.0 from the banks shows the liquidity push needs to be looked at from a different perspective, may be at a level deeper.*
- One way of looking at it could be **through Reverse Repo Rate.**
- Firstly, the Net Added Advance (NAA/NA2) matrix needs to be created for the banks on basis of the existing Priority Sector, MFI & HFC assets combined with the growth rate for last 3 FY. Let's illustrate;

Bank	Present book of PS, MFI & HFC	Average growth rate-Preceding 3 FY (%)	Target-Net Added Advance
A	100	30	30
B	200	25	50
C	500	20	100

- Once the NA2 matrix is in place, commercial banks can communicate their committed NA2 for FY 21 with projected deviation, if any,

Bank	Target-NAA	Committed NA2 (%)	Deviation (%)
A	30	100	0
B	50	150	(+)50
C	100	50	(-)50

- On basis of the committed NA2 and deviation matrix RBI then will offer Differentiated Repo Reverse Rate (DR3) at **Matched Basis Points (MBP)** to the respective banks,

Bank	Deviation (%)	Differentiator	DR3 (%)
A	0	0	3.75
B	(+)50	(+)0.5	4.25
C	(-)50	(-)0.5	3.25

This may probably encourage the banks to extend the much required liquidity to the targeted sectors like MSME, Other PS, MFIs & HFCs, which in turn will boost up resilience of those sectors, ignite faster economic recovery and set the course for economic growth, while easing the burdens on the banking sector to a great extent.

** Recommendation_Growth Focus

Setting up and/or revamping SEZs for Fully Integrated Manufacturing Facility (FIMF)

Let's take a look at the overall manufacturing space of the world. The data below might be bit old but holds good at least to depict a clear picture of the market share of the leading players.

Sl	Country	Manufacturing Output (USD in billions)	Percent of National Output	Percent of Global Manufacturing
1	**China**	**$2,010**	**27%**	**20%**
2	United States	1,867	12	18
3	Japan	1,063	19	10
4	Germany	700	23	7
5	South Korea	372	29	4
6	**India**	**298**	**16**	**3**
7	France	274	11	3
8	Italy	264	16	3
9	United Kingdom	244	10	2
10	Taiwan	185	31	2
11	Mexico	175	19	2
12	Spain	153	14	2
13	Canada	148	11	1
14	Brazil	146	11	1
15	Russian Federation	139	11	1
16	Turkey	125	18	1
17	Indonesia	115	22	1
18	Poland	100	20	1
19	Switzerland	93	18	1
20	Netherlands	88	12	1

Source: United Nations Conference on Trade and Development, 2015

Let's take a look at the impact of the manufacturing sector on the employment generation of some of the leading countries in that space;

Proportion of workforce employed in the manufacturing sector

Country	Total Number Employed in Manufacturing Sector	Percentage of Population Employed in Manufacturing
Poland	3,540,000	20.20%
China	128,869,000	16.9
India	57,244,000	11.4
United States	16,381,000	10.5

Source: International Labour Organization, 2017

Visibly, India has huge scope to scale up both in terms of employment as well as manufacturing output to GDP. While scaling up the whole manufacturing sector may sound like a far-fetched ambition which will take decades to be realized, we can always look at the pockets where it will impact the most if a focused effort is made. Let's take a look at our import & export list;

What we Import

ITEM	$US Billion	% of Total import
Mineral fuels including oil	153.5	32
Gems, precious metals	60	12.5
Electrical machinery, equipment	50.4	10.5
Machinery including computers	44.1	9.2
Organic chemicals	20.5	4.3
Plastics, plastic articles	14.6	3.1
Iron, steel	11.6	2.4
Animal/vegetable fats, oils, waxes:	9.6	2
Optical, technical, medical apparatus	9.5	2
Fertilizers	7.3	1.5

What we Export

ITEM	$US Billion	% of Total import
Mineral fuels including oil	44.1	13.7
Gems, precious metals	36.7	11.4
Machinery including computers	21.2	6.6
Organic chemicals	18.3	5.7
Vehicles	17.2	5.3
Pharmaceuticals	16.1	5
Electrical machinery, equipment	14.7	4.5
Iron, steel	9.7	3
Clothing, accessories (not knit or crochet	8.6	2.7
Knit or crochet clothing, accessories	7.9	2.5

http://www.worldstopexports.com

If we take a deeper look at the specific segments marked in colour we can infer their impact on trade deficit of the country;

Segment	$US Billion	Segment	$US Billion
Electrical machinery, equipment	50.4	Machinery including computers	21.2
Machinery including computers	44.1	Electrical machinery, equipment	14.7
Total Outflow	**94.5**	**Total Inflow**	**35.9**

Total Trade Deficit	103.63
Segment Trade Deficit	58.6
Segments' contribution to total Trade Deficit (%)	**57%**

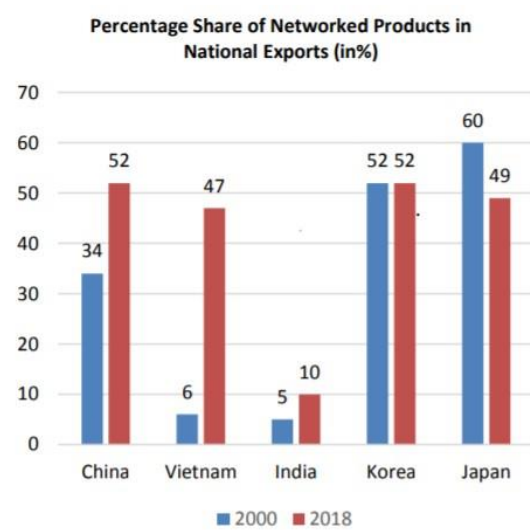
Clearly, some focused efforts made to scale up manufacturing outputs in these two segments can bring a much-desired & positive impact both on employment generation as well as fiscal balance which has already been identified as an opportunity area in the last economic survey.

Creating Jobs and Growth by Specializing in Exports of Network Products

- Growth in exports provides a much needed pathway for job creation and furthering growth in India.
- The current international environment presents India with an unprecedented opportunity to chart a China-like, labour-intensive, export trajectory and thereby create unparalleled job opportunities for our burgeoning youth.
- By integrating "Assemble in India for the world" into Make in India, India can create 4 crore well-paid jobs by 2025 and 8 crore by 2030.
- Exports of network products, expected to equal $7 trillion worldwide in 2025, can contribute a quarter of the increase in value-added for the $5 trillion economy by 2025.

Moreover according to the Survey:

- There exists a significant unexploited export potential in India's traditional unskilled labour-intensive industries such as textiles, clothing, footwear and toys.
- India has huge potential to emerge as a major hub for final assembly in a range of products, referred to as "network products" (NP). The GVCs in these industries are controlled by leading MNEs such as Apple, Samsung, Sony etc. within "producer driven" networks.



Share of NP in India's merchandise export basket is very low

Source: Economic Survey 2019-20

The world might be looking forward for our actions:

It is no more a secret that most of the global conglomerates are looking for their way out of China & will be moving their manufacturing facilities out of the dragon's land sooner than later. While some of them may also look into the possibilities of moving the jobs back to their country of origin, it is highly unlikely that they will be able to do so completely, for sheer economic reasons. With relatively low labour cost, growing infrastructure and big internal demand, India is well positioned to emerge as the natural choice for most of them. The Govt need to step in without any further delay to reach out to the global community and assure them with positive indications reaffirming India's intention and willingness. Here are some immediate initiatives that can be taken up and the messages should be spread out in the open air.

- Set up **Fully Integrated Manufacturing Facilities** across the country.
- **End to end process and whole manufacturing supply chain to be brought together** completely integrated backward to ensure continuation or quick restoration of production during the next disruption.
- **Add on the missing part** of the integration chain and complete the end to end backward integration for the existing manufacturing hubs.
- Sectors like Automobile may require longer payback period. Electronics for global consumption can be big opportunity. **Concentrate on Network products** for domestic & global consumption.

- *Introduce special tax bracket of 10-12.5% (further down from 15%) for **new manufacturing units in the Network Product** segment with an initial investment of **$ 1 billion or a net added jobs of 10,000.** The production needs to be started as early as 2022.*

- Aim for one such FIMF in all 720 districts, size/ investments may vary.
- Create sustainable local economies.

** Recommendation _ Growth Focus

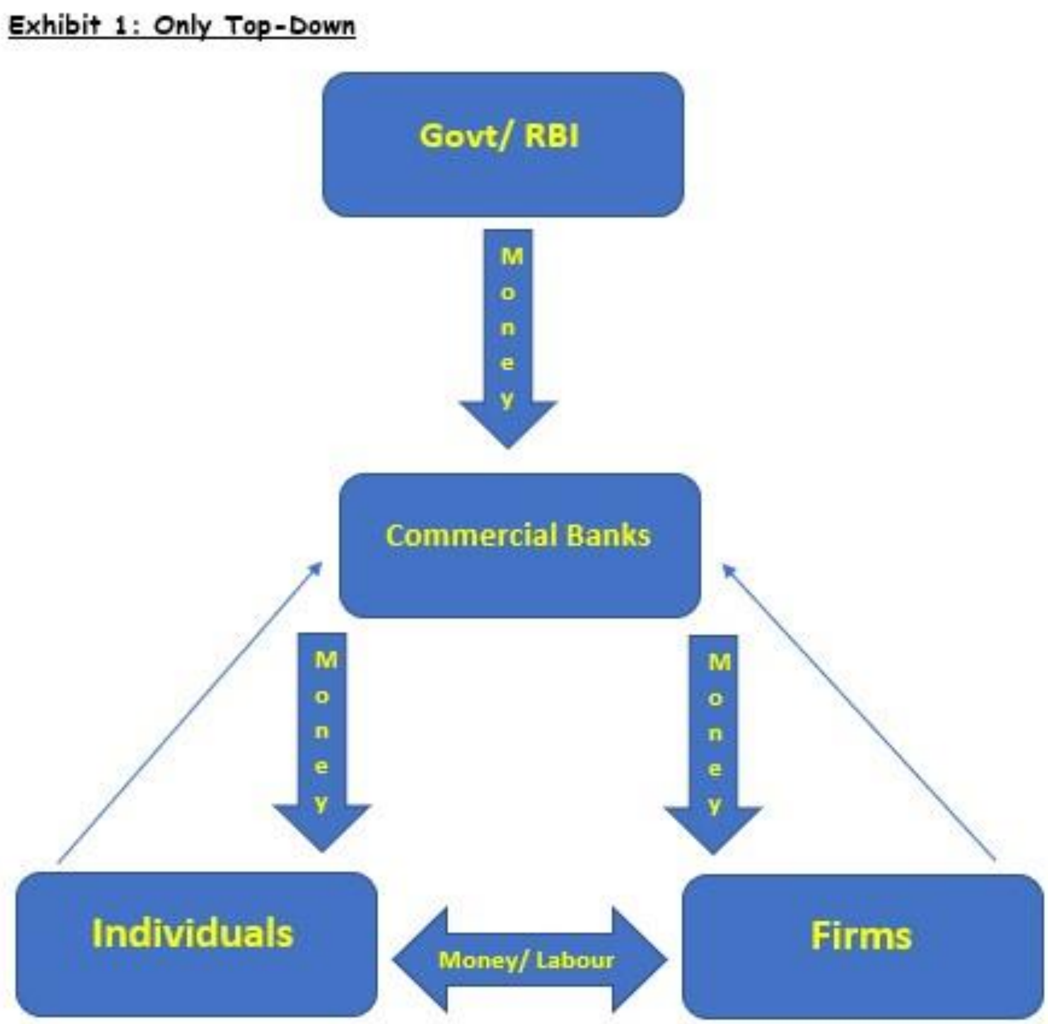
Create Long Duration Investment Incentive (LDI2) 10+ Yrs.

While we continue to work on the real economy, it is also very important to boost the confidence channels at the same time. We need to send out positive messages to the global investor community that Govt thinks & cares for them too. Also, this is the time when we should start differentiating between the real economy investors and the leveraged arbitrage money makers. We should incentivize the real FDIs over the FIIs/FPIs.

- Introduce new slab for LTCG @ 5% for longer duration, i.e., 10+ yrs. in specific sectors only.
- Use the new slab to encourage and attract long duration investments in infrastructure and manufacturing sectors only.
- To discourage leveraged arbitrage investors.
- Scrutinize and reverse (if needed) recent big-ticket transactions from non-friendly countries in essential sectors.
- To introduce LDI2 only after partial or full restoration of normal economic activities in the country to shield the positive impact from getting lost in present doom n gloom. Preferably, once US settles down.

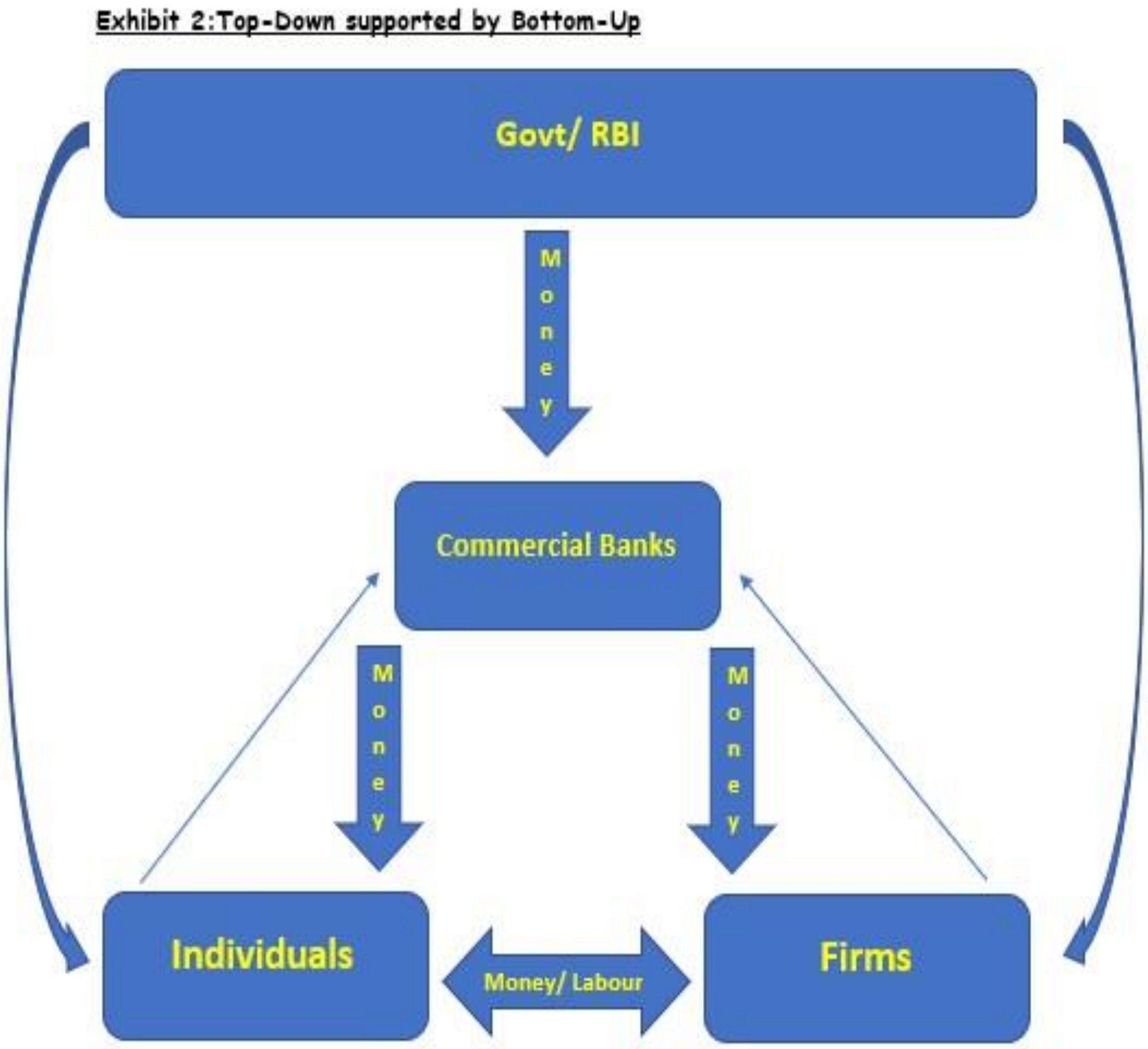
Annexures:

Exhibit 1: Top down supply of money



Annexures

Exhibit 2 : Top down supply of money supported by bottom up supply



Annexures

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Thanks

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