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ECONOMIC SURVEY

2020 - 2021

VOLUME I

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ECONOMIC SURVEY 2020-21

Introduction

- The Economic Survey is released by Chief Economic Adviser of Department of Economic Affairs, Ministry of Finance.
- Volume I - attempts to provide evidence based economic analyses of the challenges of policymaking and tools to make it more effective.
- Volume II - reviews recent developments in the major sectors of the economy with a focus on the challenges faced due to the pandemic this year.

VOLUME - I

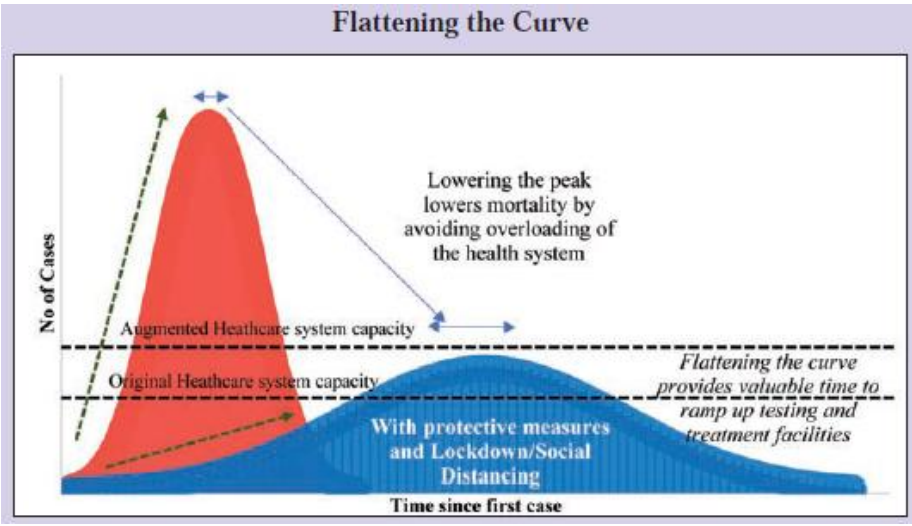
1. SAVING LIVES AND LIVELIHOODS AMIDST A ONCE-IN-A-CENTURY CRISIS

Crisis

- Covid-19 pandemic - 90% countries expected a contraction in GDP per capita
- Experience from Spanish Flu - an early, intense lockdown
- India's unique vulnerabilities
    1. Huge population
    2. High population density
    3. Higher number of vulnerable elderly population (Although the average age is low)
    4. Overburdened health infrastructure

Response

- Having unique vulnerabilities, India imposed the most stringent lockdown at the very onset.
- The strategy was motivated by the Nobel-Prize winning research which recommended a policy focused on minimizing losses in a worst case scenario when uncertainty is very high.
- India also adopted a strategy of Bayesian updating to continually calibrate its response while gradually unlocking and easing economic activity.



- 'Flattening of the curve' was the main aim i.e spreads the pandemic over time, enabling more people to receive proper health treatment and lowering the fatality rate.
- Basic Reproduction Number (R0) - expected number of new cases of the disease caused by a single individual
    1. If R0 < 1 - disease eventually peters out
    2. If R0 =1 - will not lead to an epidemic
    3. If R0 > 1 - epidemic
- Another important factor is Case-Fatality Ratio (CFR) i.e fraction of individuals infected who lose their life due to the disease.
- Indian adopted '5 T' strategy in healthcare - Test, Track, Trace, Treat, Technology.
- So India became the only country other than Argentina to not have a 2nd wave. (Recovery Rate - almost 96%).

Fiscal Activities

- Pradhan Mantri Garib Kalyan Yojana (PMGKY) for ensuring food security through PDS
- Direct benefit transfers to widows, pensioners and women
- Additional funds for MGNREGS
- Debt moratoria & Liquidity Support for businesses
- Followed by support to investment and consumption through Atmanirbhar 2.0 & 3.0
- **National Infrastructure Pipeline** to accelerate this demand push and further the recovery

Structural Reforms

Sector	Structural Reform Undertaken
	Deregulation and Liberalization of Sectors
Agriculture	• Farmers' Produce Trade and Commerce (Promotion and Facilitation) Act, 2020 • Farmers (Empowerment and Protection) Agreement of Price Assurance and Farm Services Act, 2020 • Essential Commodities (Amendment) Act, 2020
Corporates	• Including the provisions of Part IXA (Producer Companies) of Companies Act, 1956 in Companies Act, 2013 • Decriminalization of Companies Act defaults involving minor technical and procedural defaults • Power to create additional/ specialized benches for NCLAT • Lower penalties for all defaults for Small Companies, One-person Companies, Producer Companies & Start Ups • Simplified Proforma for Incorporating Company Electronically Plus (SPICe +) introduced
Administration	• National platform for recruitment: National Recruitment Agency to conduct a Common Eligibility Test • Revised guidelines on Compulsory retirement to remove ineffective or corrupt officials through Fundamental Rule 56(j)/(l) and Rule 48 of CCS (Pension) Rule • Faceless tax assessment and a 12-point taxpayers charter • Fast track Investment Clearance through Empowered Group of Secretaries

MSMEs	• New MSME definition covering almost 99 per cent of all firms enabling MSMEs to grow in size and create jobs • Removal of artificial separation between manufacturing and service MSMEs
Labour	• Enactment of four labour codes namely, Wage Code, Industrial Relations Code, 2020, Code on Occupational Safety, Health & Working Conditions Code, 2020 & Social Security Code, 2020 • 'One labour return, one licence and one registration'
Business Process Outsourcing (BPO)	• Simplification of the Other Service Provider (OSP) guidelines of the Department of Telecom. Several requirements, which prevented companies from adopting 'Work from Home' and 'Work from Anywhere' policies have been removed
Power	• Tariff Policy Reform: DISCOM inefficiencies not to burden consumers, Progressive reduction in cross subsidies, Time bound grant of open access, etc. • Privatization of Distribution in UTs
PSUs	• PSUs in only strategic sectors • Privatization of PSUs in non-strategic sectors
Mineral Sector	• Commercial Mining in Coal Sector • Removal of distinction between captive and merchant mines • Transparent auction of mining blocks • Amendment to Stamp Act, 1899 to bring uniformity in stamp duty across States • Introduction of a seamless composite exploration-cum-mining-cum-production regime
Strengthening Productive Capacity	
Industry	• Production Linked Incentive (PLI) Scheme for 10 identified sectors • National GIS-enabled Land Bank system launched
Space	• Level playing field provided to private companies in satellites, launches and space-based services • Liberal geo-spatial data policy for providing remote-sensing data to tech-entrepreneurs
Defence	• Corporatization of Ordnance Factory Board • FDI limit in the Defence manufacturing under automatic route to be raised from 49 per cent to 74 per cent. • Time-bound defence procurement process
Strengthening Productive Capacity	
Education	• PM-eVidya to enable multi-mode and equitable access to education • Manodarpan initiative for psychosocial support
Social Infrastructure	• Scheme for Financial Support to Public Private Partnerships (PPPs) in Infrastructure Viability Gap Funding (VGF) Scheme extended till 2024-25
Ease of Doing Business	
Financial Markets	• Direct listing of securities by Indian public companies in permissible foreign jurisdictions • Provisions to reduce time line for completion of rights issues by companies • Private companies which list NCDs on stock exchanges not to be regarded as listed companies

MSME Reforms (definition)

- Micro Enterprises - investment up to Rs 1 crore and turnover up to Rs 5 crore (Old - investments up to Rs 25 lakh for manufacturing & up to Rs 10 lakh for services)
- Small Enterprises - up to Rs 10 crore in investment and Rs 50 crore in turnover (Old definition - investment of up to Rs 5 crore in manufacturing and up to Rs 2 crore in services)

- Medium Enterprises - investment limit has been doubled for manufacturing enterprises from Rs 10 crore to Rs 20 crore and quadrupled for services from Rs 5 crore to Rs 20 crore, in addition to the turnover criteria of up to Rs 100 crore for both sectors in this size.

Labour Reforms

- Increase in the size thresholds from 10 to 20 employees to be called a factory, 20 to 50 for contract worker laws to apply, and 100 to 300 for standing orders.
- 41 central labour laws being reduced to four & Number of sections falling by 60%
- Multiple numbers of minimum wages in different states reducing from 2000 to just 40.
- One registration instead of six & One license instead of four
- De-criminalisation of several offences

Mining Sector Reforms

- Measures to increase private participation
- Redefine the standard of exploration required for auctioning of blocks for prospecting license-cum mining lease and open acreage licensing policy for allocation of mining rights.

Recovery

- **V-shaped recovery -** after experiencing a sharp contraction of 23.9% in first quarter of 2020-21, followed by only 7.5% decline in Q2 and the recovery across all key economic indicators.
- Now, India is expected to be the fastest growing economy in next 2 years (IMF)

2. DOES GROWTH LEAD TO DEBT SUSTAINABILITY? YES, BUT NOT VICE-VERSA!

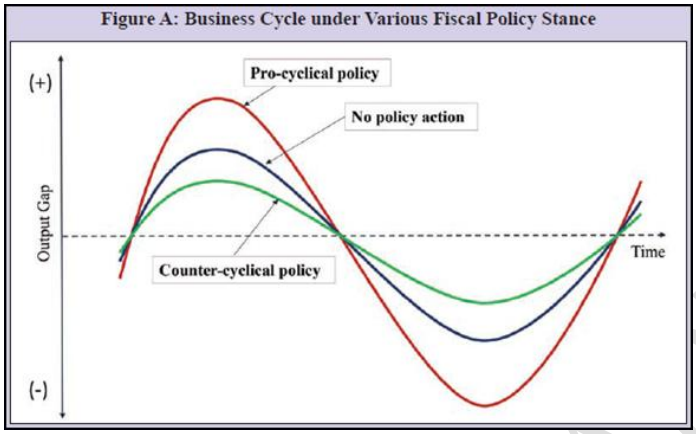
Aim

- Sensible fiscal policy is salient during an economic crisis, even more during fiscal expansion measures following COVID.
- This is because the fiscal expansion is usually followed by concerns about debt sustainability and sovereign ratings.
- So this chapter aims to establish clearly that growth leads to debt sustainability in the Indian context but fiscal austerity does not foster growth.

Pro-Cyclical vs Counter-Cyclical Fiscal Policy

- A counter-cyclical fiscal policy refers to strategy by the government to counter boom or recession through fiscal measures.
- It stabilizes the business cycle by being contractionary (reduce spending/increase taxes) in good times and expansionary (increase spending/reduce taxes) in bad times.

- On the other hand, pro-cyclical fiscal policy reinforces the business cycle by being expansionary during good times and contractionary during recessions.
- e.g Indian Kings used to build palaces during famines and droughts to provide employment and improve the economic fortunes of the private sector.

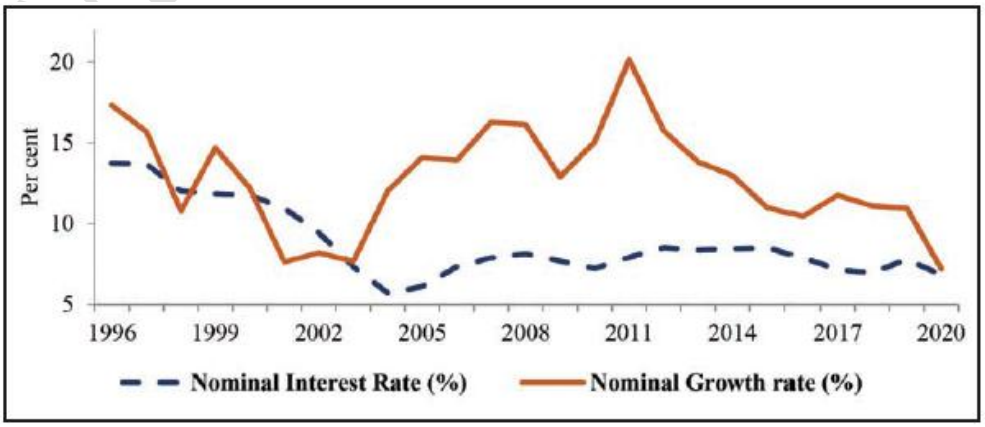


Growth vs Debt

- The growth leads to debt sustainability in the Indian context but not necessarily vice-versa.
- This is because the interest rate on debt paid by the Indian government has been less than India's growth rate by norm, not by exception.
- "If the interest rate paid by the government is less than the growth rate, then the inter-temporal budget constraint facing the government no longer binds." - Blanchard
- Debt sustainability is dependent on the "interest rate growth rate differential" (IRGD), i.e. the difference between the interest rate and the growth rate.

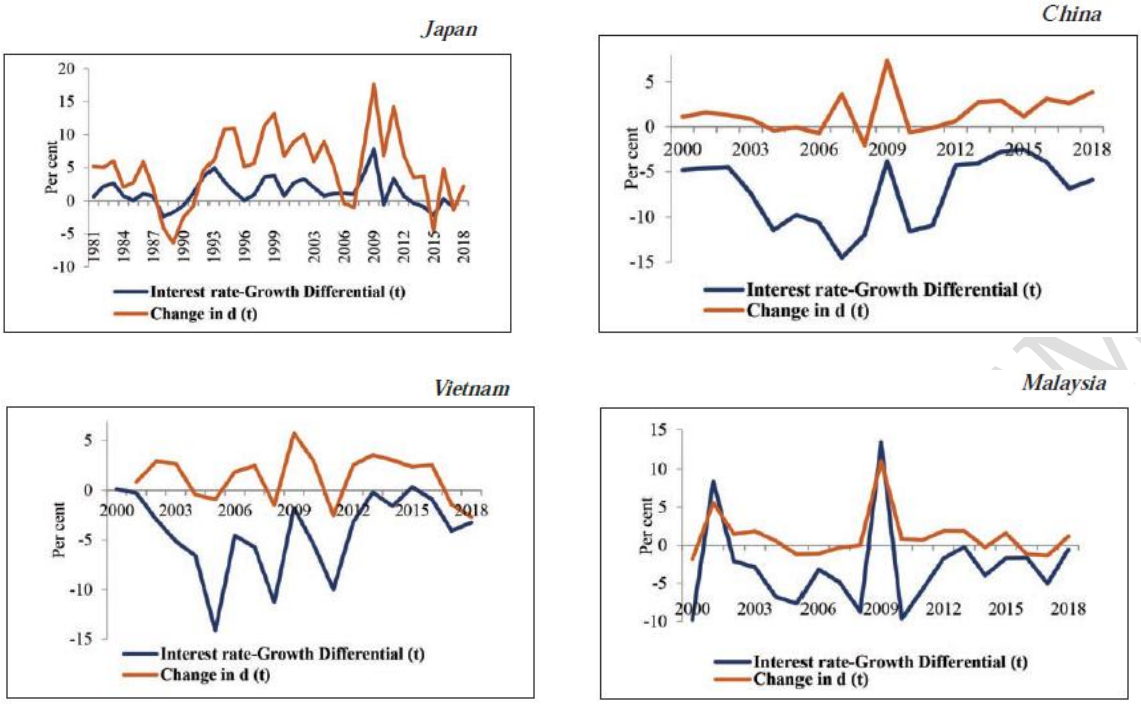
Justification for Fiscal Expansion

- **Higher Growth Rate -** In advanced economies, the extremely low interest rates that led to negative IRGD, have placed limitations on monetary policy.
- But negative IRGD in India is not due to lower interest rates but much higher growth rates.



- **International Examples -** There is also evidence across several countries to show that growth causes debt to become sustainable in countries with higher growth rates.

- The negative IRGD is accompanied by a steeper decline in debt levels across the countries.



- **Low Debt -** India's public debt-to-GDP has been significantly low compared to high global debt levels.

Figure 17: Debt-to-GDP ratio for India amongst the Rest of the world (2018)

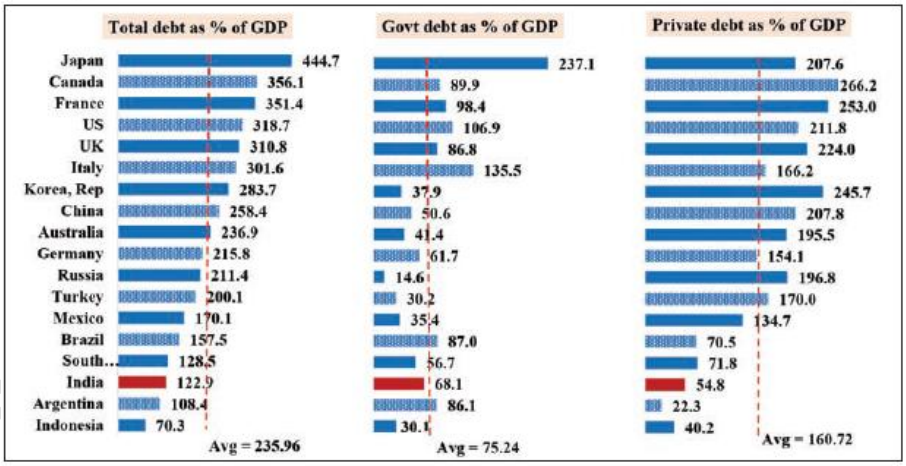


Figure 19: Composition of General Government public debt

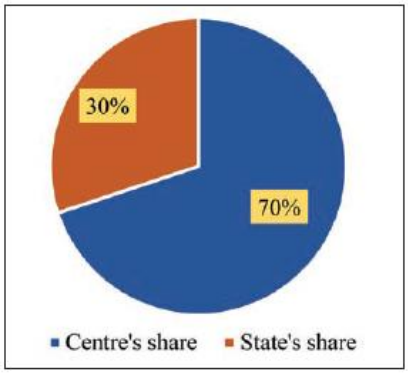
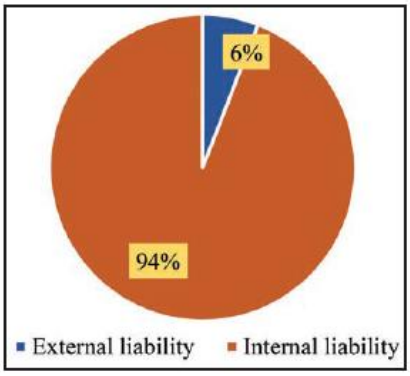


Figure 20: Composition of Central Govt. debt



- IRGD is also expected to be negative in the foreseeable future and so expansionary fiscal policy will lead to lower, not higher, debt-to-GDP ratios.
- Given the India's growth potential till 2030, debt sustainability is unlikely to be a problem even in the worst case scenarios.
- Therefore India can be more relaxed about debt and fiscal spending during a slowdown or an economic crisis.
- Thus it is desirable to use counter-cyclical fiscal policy to enable growth during economic downturns.
- It can boost potential growth with multi-year public investment packages that raise productivity. E.g National Infrastructure Pipeline (NIP) could generate higher-paying jobs and boost productivity.
- At a time of excessive risk aversion in the private sector, risk taking via public investment can catalyse private investment.

3. DOES INDIA'S SOVEREIGN CREDIT RATING REFLECT ITS FUNDAMENTALS NO!

Backstory

- Currently, India is rated investment grade BBB-/Baa3 by three major CRAs – S&P, Moody's & Fitch.
- Usually, the 5th largest economy of the time has been predominantly rated AAA.
- This is done considering the economic size and thereby the ability to repay debt.
- However, China and India are the only exceptions to this rule.
- China was rated A-/A2 in 2005 and now India is rated BBB-/Baa3.

Credit Rating Scale Comparison between some major CRAs

Interpretation	Fitch and S&P	Moody's
Highest quality	AAA	Aaa
High quality	AA+	Aa1
	AA	Aa2
	AA–	Aa3
Strong payment capacity	A+	A1
	A	A2
	A–	A3
Adequate payment capacity	BBB+	Baa1
	BBB	Baa2
	BBB–	Baa3
Likely to fulfill obligations, on going uncertainty	BB+	Ba1
	BB	Ba2
	BB–	Ba3
High-risk obligations	B+	B1
	B	B2
	B–	B3
Vulnerable to default	CCC+	Caa1
	CCC	Caa2
	CCC–	Caa3
Near or in bankruptcy or default	CC	Ca
	C	C
	D	D

Aim

This chapter aims to prove that the fundamentals that drive sovereign credit ratings do not justify this poor rating.

Proof

- Credit ratings map the **probability of default** and therefore reflect the **willingness and ability** of borrower to meet its obligations.
- However, India's willingness to pay is unquestionably demonstrated through its history of zero sovereign default.
- India's ability to pay can be measured not only by the extremely low foreign currency denominated debt of the sovereign but also by the comfortable size of its Forex reserves.

- India is also a clear outlier on several parameters during the last two decades, including

1) GDP growth rate, inflation,
2) General government debt (as % of GDP),
3) Cyclically adjusted primary balance (as % of potential GDP),
4) Current account balance (as % of GDP),
5) Political stability,
6) Rule of law,
7) Control of corruption,
8) Investor protection,
9) Ease of doing business,
10) Short-term external debt (as % of reserves),
11) Reserve adequacy ratio &
12) Sovereign default history

- India's forex reserves (US$ 584.24 bn) are greater than India's total external debt (US$ 556.2 bn).
- India's non-government short term-debt as per cent of forex reserves stood at 19%.
- India's forex reserves can cover an additional 2.8 standard deviation negative event i.e. an event that can be expected to manifest with a probability of less than 0.1% after meeting all short-term debt.
- This shows that the ratings do not capture India's fundamentals.

Effects of Poor Ratings

- India has witnessed 4 instances of a sovereign credit ratings downgrade and 7 instances of a sovereign credit ratings upgrade.
- These ratings have not had major adverse impact on select indicators such as Sensex return, foreign exchange rate and yield on government securities, damaging FPI flows.

Table 2: Summary of Average Changes in Select Indicators during India's Sovereign Credit Rating Downgrades (1998-2018)

Indicator	During/Post event	Short Term			Medium Term			Long Term		
Sensex return	During event	-1.14%			-3.73%			34%		
	Post event	0.38%			0.5%			26%		
Exchange Rate	During event	-0.01%			1.3%			9%		
	Post event	-0.01%			0.2%			2%		
G Sec Yield		5 yr	10 yr	Spread	5 yr	10 yr	Spread	5 yr	10 yr	Spread
	During event	-	-	-	-1.4%	-3.3%	-22%	-	-	-
	Post event	-	-	-	0.1%	-0.3%	1%	-	-	-
FPI Flows		Equity	Debt		Equity	Debt		Equity	Debt	
	During event	-	-		-	-		-67%	-289%	
	Post event	-	-		-	-		-759%	-114%	

Note: Green indicates positive economic outcome, Red indicates negative economic outcome

Table 3: Summary of Average Changes in Select Indicators during India's Sovereign Credit Rating Upgrades (1998-2018)

Indicator	During/Post event	Short Term			Medium Term			Long Term		
Sensex return	During event	-0.7%			2%			36%		
	Post event	0.2%			1.8%			13%		
Exchange Rate	During event	-0.05%			-0.29%			-1.5%		
	Post event	-0.03%			-0.36%			-2.3%		
G Sec Yield		5 yr	10 yr	Spread	5 yr	10 yr	Spread	5 yr	10 yr	Spread
	During event	-	-	-	0.2%	-0.5%	-5%	-	-	-
	Post event	-	-	-	0.6%	0.7%	5%	-	-	-
FPI Flows		Equity	Debt		Equity	Debt		Equity	Debt	
	During event	-	-		-	-		264%	286%	
	Post event	-	-		-	-		303%	578%	

Note: Green indicates positive economic outcome, Red indicates negative economic outcome

Recommendations

- It is therefore imperative that countries engage with CRAs to make the case that their methodology is wrong.
- Moreover, the pro-cyclical nature of credit ratings and its potential adverse impact on economies must be expeditiously addressed.
- India's fiscal policy must, therefore, not remain beholden to such a biased measure of India's fundamentals.

4. INEQUALITY AND GROWTH: CONFLICT OR CONVERGENCE?

Backstory

- Economic Survey 2019-20 argued that ethical wealth creation i.e by combining the invisible hand of markets with the hand of trust, will provides the way forward for India's development.
- A concern expressed with this economic model is **inequality**.
- It is argued that inequality is an essential feature of capitalism, highlighting a potential conflict between economic growth and inequality.
- This has become more relevant due to inequality following the COVID-19 pandemic.

Aim

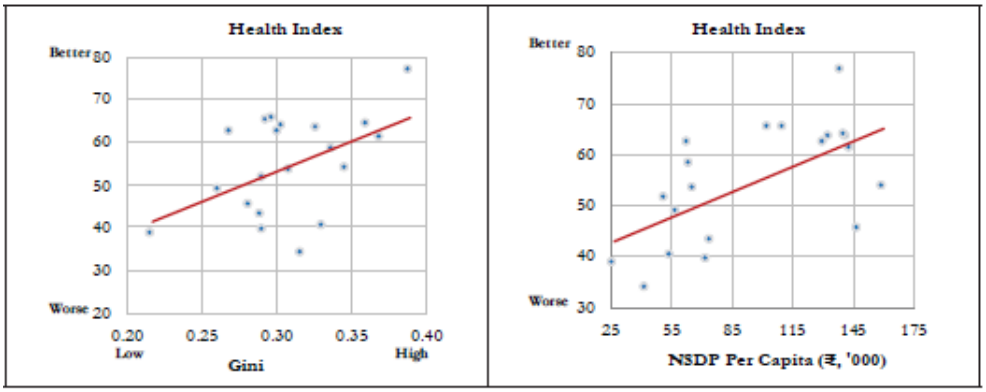
It aims to examine if inequality and growth conflict or converge in India.

Findings

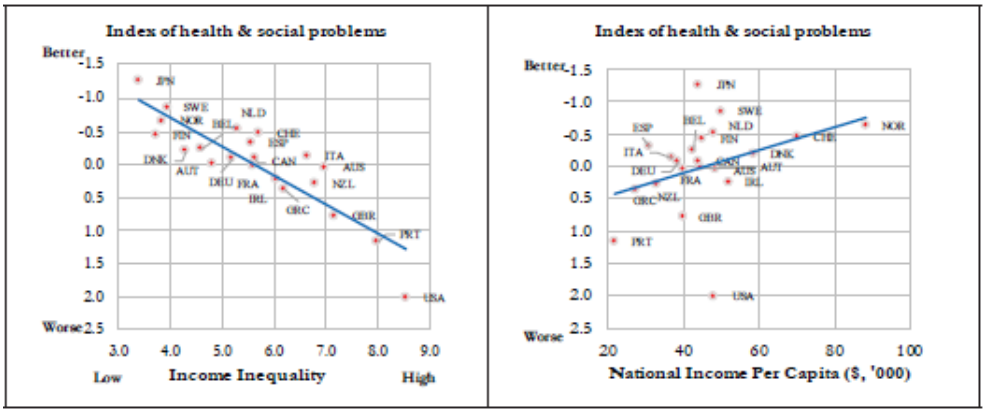
- The correlation of inequality and per-capita income is examined with a range of socio-economic indicators, including health, education, life expectancy, infant mortality, birth and death rates, fertility rates, crime, drug usage and mental health.
- The result is that both economic growth and inequality have similar relationships with socio-economic indicators i.e High economic growth has delivered significant reduction in poverty in India.
- The economic growth has a far greater impact on poverty alleviation than inequality.
- Thus, unlike in advanced economies, in India economic growth and inequality converge in terms of their effects on socio-economic indicators.
- Further, in Indian states, asset inequality is much higher than consumption inequality.
- This is because the households attempt to smooth their consumption by borrowing or saving.
- Hence, while the income varies from year to year, consumption is more permanent as individuals tend to smooth their consumption over time.
- Measures of calculating income do not take into consideration all the available resources that result into well-being.

Figure 1: Correlation of inequality and growth (as reflected in income per capita) with health outcomes: India versus Advanced Economies

States in India



Advanced Economies



Recommendations

- India must continue to focus on economic growth to lift the poor by expanding the overall pie.
- However this does not imply that redistributive objectives are unimportant, but that redistribution is only feasible in a developing economy if the size of the economic pie grows.

Case Study - Poverty & Inequality Trade-off in China

- Accelerating industrialization and urbanization in China has transformed a large number of the agricultural surplus labor in the countryside into urban employment.
- Low-income rural households have benefitted proportionally from this changes in the country's employment pattern.
- World Bank research argues that benefits of China's sustained economic growth have really trickled down.
- This was also aided by a good system of equal land reforms, social development programs in rural areas since 2000 (including universal compulsory education up to grade 9, rural medical system, social pension system, and a minimum living allowance scheme) and targeted poverty reduction programs, in place nationally since 1986.

5. HEALTHCARE TAKES CENTRE STAGE, FINALLY!

Aim

The chapter aims to prove the necessity to construct an agile health infrastructure in order to fight future pandemics.

Importance of Healthcare

- Health affects domestic economic growth directly through labour productivity and the economic burden of illnesses.
- Life expectancy in a country correlates positively with per-capita public health expenditure, whereas maternal mortality correlates negatively.
- Out-Of-Pocket Expenditures (OOPEs) for health increase the risk of vulnerable groups slipping into poverty because of catastrophic health expenditures.

Present Conditions

- On quality and access of healthcare, India was ranked 145th out of 180 countries (Global Burden of Disease Study 2016).
- Hospitalisation rate of 3-4% is among the lowest in the world (average for middle income countries is 8-9%).
- This reflects lower access and utilisation of healthcare.
- India has one of the highest levels of OOPEs in the world.
- Health is a state subject in India, so 66% of spending on healthcare is done by the states.
- India ranks 179th out of 189 countries in prioritization of health its government budgets (union & state).
- Aggregate human resources for health density in India is close to the lower threshold of 23/10,000 people but the skill mix (doctor/nurse-midwives ratio) is far from adequate.
- There is also inter-state variability,
    1) Kerala and J&K have a high density of doctors
    2) Punjab, HP and Chhattisgarh have a larger number of nurses and midwives but a very low density of doctors
    3) Andhra Pradesh, Delhi and TN reflect a better balance of doctors, nurses & midwives

Insufficiencies in Health Sector

- Free markets fail to organise robust healthcare systems because of
    1) uncertainty/variability of demand
    2) information asymmetry
    3) hyperbolic tendencies - indulging in risky behavior that may not be in their self-interest, like smoking, eating unhealthy food, delay in seeking care etc

- Typically, consumers tend to demand primary care less than the economically optimal levels as the price elasticity for this product/service is very high.
- Individuals also under-estimate health risks & tend not to purchase adequate health insurance.
- Around 74% of outpatient care and 65% of hospitalisation care is provided through the private sector in urban India.
- Unplanned readmissions are costlier than original admissions and impose a heavy burden on patients.

Recommendations

- Healthcare policy must not become beholden to "saliency bias" (focus on items that are more prominent) focussing on recent phenomenon, which is a six-sigma event (extremely rare-COVID).
- Pooling of healthcare expenditures via health insurance can help to reduce healthcare risk at the macroeconomic level, arising due to uncertain demand.
- Telemedicine can provide healthcare access in remote areas so investments in internet connectivity & health infrastructure is to be made.
- Measures like Telemedicine Practice Guidelines 2020 & eSanjeevani OPD are in line with this.
- National Health mission (NHM) has played a critical role in mitigating inequity as the access of the poorest to pre-natal and post-natal care as well as institutional deliveries has increased significantly. So, the emphasis on NHM should continue.
- An increase in public spend from 1% to 2.5-3% of GDP as envisaged in the National Health Policy 2017, can decrease the Out-Of-Pocket Expenditures from 65% to 30% of overall healthcare spend.
- As bulk of the healthcare in India is provided by the private sector, it is critical for policymakers to reduce information asymmetry in healthcare, which creates market failures.
- e.g Quality and Outcomes Framework (QOF) introduced by the National Health Service (NHS) in the United Kingdom 2004.
- A sectoral regulator to undertake regulation and supervision of the healthcare sector must be considered, given the market failures stemming from information asymmetry.
- The mitigation of information asymmetry would also help lower insurance premiums, enable the offering of better products and help increase the insurance penetration.

6. PROCESS REFORMS: ENABLING DECISION-MAKING UNDER UNCERTAINTY

Backstory

- Time and procedures taken for a company to undergo voluntary liquidation in India is studied.
- Even when there is no dispute/litigation and when all paperwork is complete, it takes 1570 days to be stuck off from the records.
- In contrast, voluntary liquidation takes about 12 months in Singapore, 12-24 months in Germany and 15 months in UK.

Aim

The chapter aims to prove that problems in India's administrative processes do not arise from lack of compliance to regulatory standards, but from overregulation.

Findings

- Problem of over-regulation and opacity flows from the emphasis on having complete regulations that account for every possible outcome.
- In 'World Rule of Law Index' published by the World Justice Project India ranks 69th out of 128 countries. Also,
    1. 45th in the category of 'Due process is respected in administrative proceedings'
    2. 104th in 'Government regulations are effectively enforced'
    3. 89th in 'Administrative Proceedings are conducted without unreasonable delay'
    4. 107th in 'Administrative Proceedings are applied and enforced without improper influence'
- This shows that India is relatively good at complying with processes, but lag in regulatory effectiveness.
- This is due to the inadequate appreciation of the difference between 'Regulation' & 'Supervision', on the one hand, and the inevitability of incomplete regulations, on the other.
- Real-world regulation is inevitably incomplete because of the combination of
    1. bounded rationality due to "unknown unknowns"
    2. complexity involved in framing "complete" contracts across all possible contingencies &
    3. the difficulty for a third party to verify decisions
- So some level of discretion is unavoidable in decision making.
- Evidence also suggests that over-regulation leads to opaque decision making.
- But policymakers ignore this and tend to favour regulation as it can be easily measured through criteria or checklists.
- In contrast, it is difficult to quantify the amount and quality of supervision.

Recommendations

- The solution is to have simple regulations combined with transparent decision making.
- The discretion accorded to decision maker should be balanced with three things
    1. Improved transparency,
    2. Stronger systems of ex-ante accountability i.e instead of relying too much on ex-post audits, accountability needs to be entrusted with the officials who are presumed to act in good faith
    3. Ex-post resolution mechanisms i.e efficient legal systems (courts and institutions) such as Insolvency and Bankruptcy Code (IBC), Debt Recovery Tribunals etc.

Recent reforms in line with the recommendations

- The new GeM portal has increased the transparency in pricing in government procurement at the same time reduced the cost of procurement and made it easier for the government officials to make decisions.

- Labour falls under the Concurrent List of the Constitution, therefore there were over 100 state and 40 central laws regulating various aspects of labour.
- Recently Government merged the existing 29 central labour laws into 4 labour codes.

7. REGULATORY FORBEARANCE: AN EMERGENCY MEDICINE, NOT STAPLE DIET!

Aim

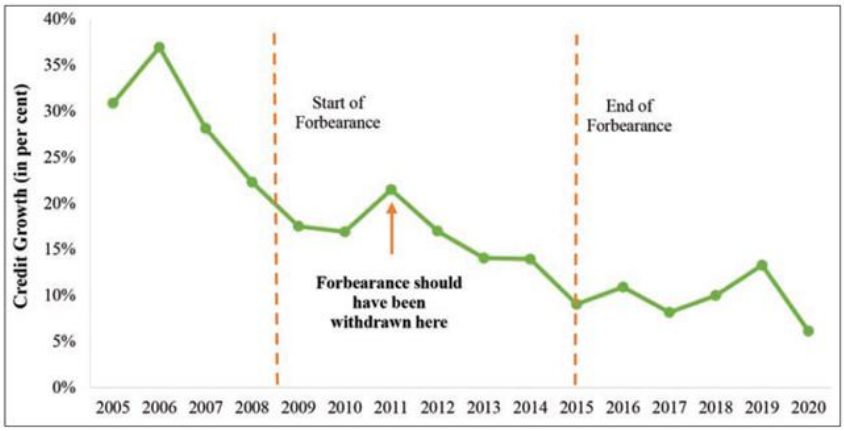
This chapter studies the impact of the 2008 forbearance policy on banks, firms, and the economy in general to extract important lessons for the current times.

Regulatory forbearance for banks

- It means relaxing the norms for restructuring assets, where restructured assets were no longer required to be classified as Non-Performing Assets.
- Restructuring of loans means when a bank alters the terms of credit in order to help the borrower, like extending of loan period.
- Therefore, banks prefer restructuring, as forbearance allows them to declare fewer NPAs and avoid the costs due to loan provisioning.
- This is because the banks will not require provisioning of NPAs, which adds additional cost.
- During the Global Financial Crisis 2008, RBI introduced forbearance that helped borrowers tide over temporary hardship caused due to the crisis.

Effectiveness

- The forbearance policies had desired short-term economic effects.
- GDP growth recovered from a low of 3.1% in FY2009 to 8.5% within 2 years (2010).
- Yet, the forbearance continued for five more years till 2015, long after the economic recovery.
- This has resulted in unintended and detrimental consequences.



Source: RBI Table on Annual Account of SCBs

Impact of Forbearance

- Banks exploited the forbearance window to restructure loans even for unviable entities (verge of defaulting), by window-dressing their books.

Figure 7: Higher Restructuring by PSBs

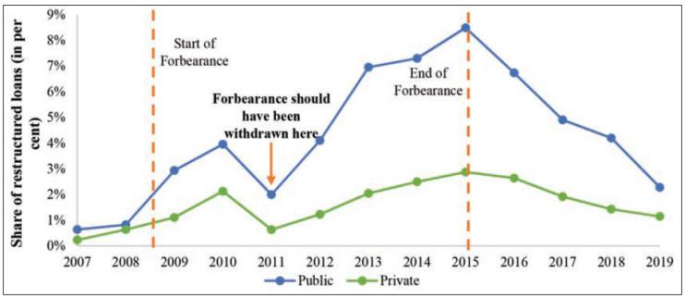
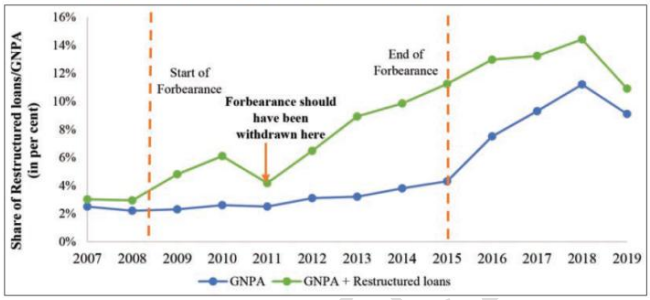


Figure 8: Gross Non-performing Assets and Restructured loans



- P. J. Nayak Committee (2014), constituted by RBI reported that the twin concerns stemming from the forbearance regime are
    1. Ever-greening of loans by classifying NPAs as restructured assets &
    2. Resultant undercapitalization of banks
- **Ever-greening** of loans means lending a new loan to a borrower on the verge of default or by directing credit to healthy firms in the business group to which the unviable borrower belongs.
- There was an increase in assets that would have otherwise been categorized as NPAs.
- Hence the banks became **undercapitalized** i.e overstating the actual capital and creating a false sense of security.
- This has unduly inflated profits which were then used by banks to pay increased dividends to shareholders.
- The forbearance period also witnessed an increase in lending to unproductive firms, popularly referred to as "**zombies**".
- Injudicious credit supply and lax monitoring lead to deterioration in borrowing firm's corporate governance.
- By the time forbearance ended in 2015, restructuring had increased seven times while NPAs almost doubled.
- Undercapitalization → distorted banks' incentives → banks misallocated credit → damage to the quality of investment in the economy (investments in unviable projects)

Early vs Late resolvers of Forbearance

Early Resolvers (2009-2010)		Late Resolvers (2015-2019)	
	Peak NPA as % of assets		Peak NPA as % of assets
Brazil	4.21	Argentina	5.75
Canada	1.27	China	2.40
Germany	3.31	India	9.98
Indonesia	3.29	Italy	18.06
Saudi Arabia	3.29	Portugal	17.48
South Africa	5.94	Russia	10.12
United States	4.96	Turkey	5.02
Australia	2.15		
South Korea	0.59		
Average	3.22	Average	9.83

Source: IMF

After-Effects

- RBI initiated an Asset Quality Review in 2015 to clean up bank balance sheets.
- While gross NPAs peaked at 11.2% in 2017-18, the AQR could not bring out all the hidden bad assets.
- This led to a second round of lending distortions, worsening an already grave situation.
- However a new phase of regulatory forbearance was launched following the COVID crisis.

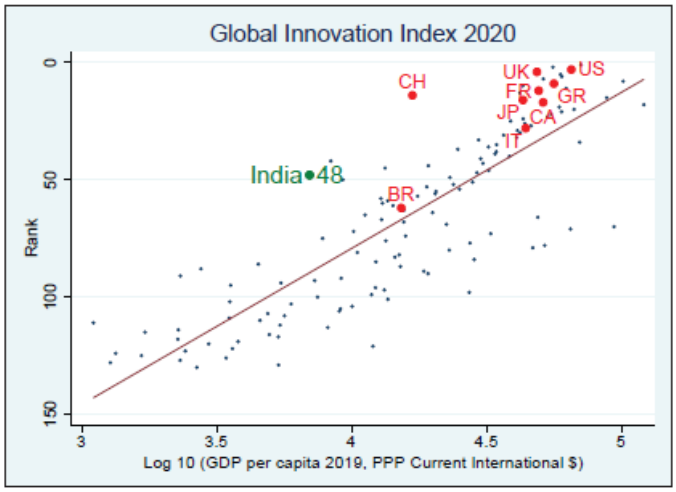
Recommendations for Current Regime

- Emergency measures such as forbearance should not be extended even after recovery.
- Therefore, policymakers should lay out thresholds of economic recovery at which such measures will be withdrawn.
- These thresholds should be communicated to the banks in advance so that they can prepare for the same.
- An AQR exercise must be conducted immediately after the forbearance is withdrawn.
- This should be followed by mandatory recapitalization based on a thorough evaluation
- The judicial infrastructure for the implementation of Insolvency and Bankruptcy Code – comprised of Debt recovery tribunals, National Company Law Tribunals, and the appellate tribunals – must be strengthened substantially.

8. INNOVATION: TRENDING UP BUT NEEDS THRUST, ESPECIALLY FROM THE PRIVATE SECTOR

Backstory

- India has improved its rank in Global Innovation Index (GII) from 81 in 2015 to 48 in 2020.
- Among the seven pillars of the GII, India ranks
    1. 27th in knowledge and technology outputs (KTO)
    2. 31st in market sophistication
    3. 55th in business sophistication
    4. 60th in human capital and research (HCR)
    5. 61st in institutions
    6. 64th in creative output
    7. 75th in infrastructure

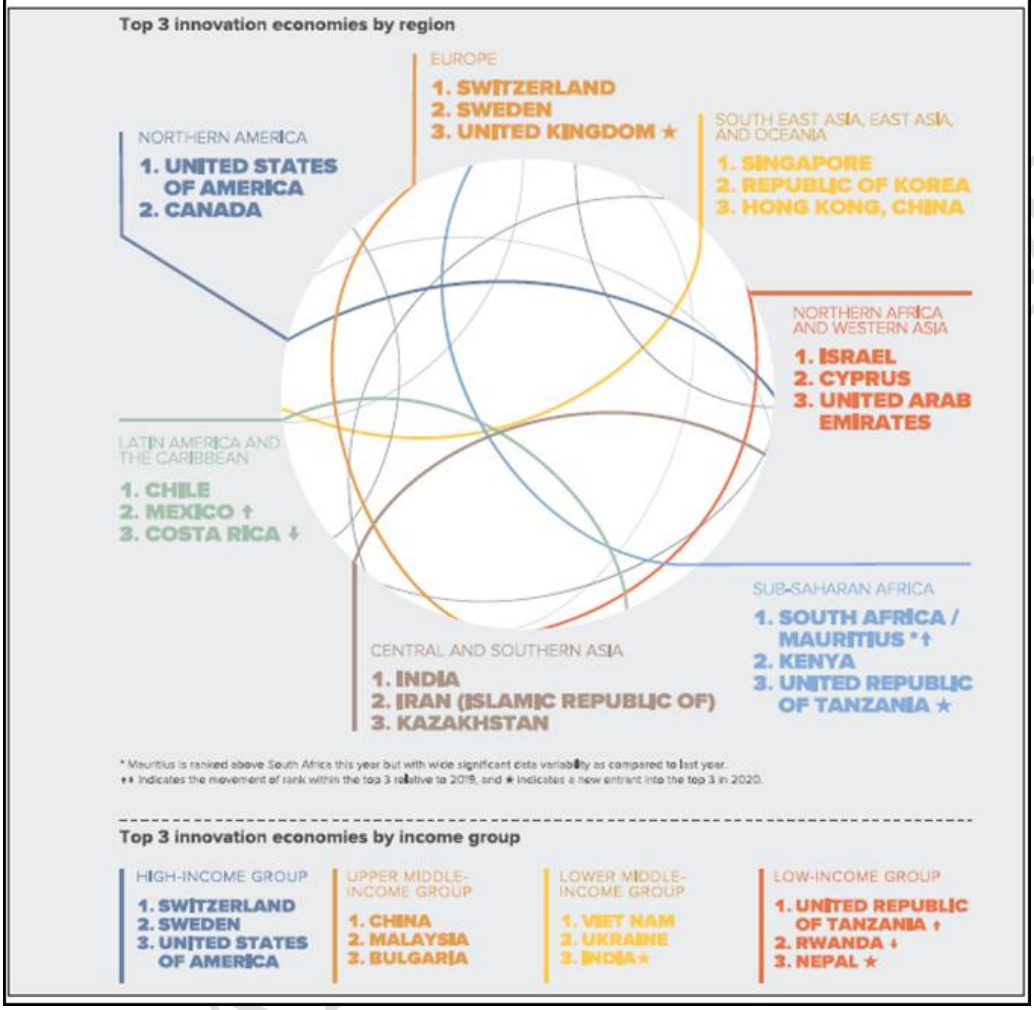


- GII also highlights areas with scope for improvement.
    1. 107th on education
    2. 118th on pupil-teacher ratio in secondary education
    3. 115th on new business per thousand population in ages 15-64

4. 108th on ICT access as well as ICT use

- There is a positive correlation between past innovation performance and current GDP per capita.

Figure 2: Global Leaders in Innovation in 2020



Reasons for Poor Performance

- India's gross expenditure on R&D is at 0.65% of GDP, out of which the government contributes 56%. (3 times the average contributed by governments in the top 10 economies).
- Indian government also contributes the highest share of total R&D personnel (36%) and researchers (23%).
- This shows that the contribution of businesses to innovation is very less in India, despite a generous tax incentive structure to boost R&D.
- Indian residents contribute only 36% of patents filed in India.
- Around 6% of US-resident inventors listed at the European Patent Office in 2009 had an Indian name and surname. This is more than the French, Germans and Italians combined.
- This means that there is a large-scale out-migration of skilled workforce and students.
- To encourage the return of higher-skilled workforce there should be an environment that facilitates re-entry into the Indian job-market and high-tech research opportunities.

- Another reason is the low level of access to equity finance, which is the most crucial for innovation.

Recommendations

- India must significantly increase investment in R&D, especially by business sector.

Suggested Focus Areas for boosting Innovation Performance

Input Pillar and Potency of Expected Impact	Build on strengths	Improve
Institutions **Potency of potential impact:** One standard deviation improvement in Institutions rank from 61 in 2020 to 23 is expected to increase overall Innovation Output rank to 40 from 45 in 2020	• Ease of resolving insolvency (rank 47) • Government effectiveness (rank 55)	• Ease of starting a business (rank 105) • Political and operational stability (rank 83) • Regulatory quality (rank 84) • Rule of law (rank 62) • Cost of redundancy dismissal (rank 61)
Business Sophistication **Potency of potential impact:** One standard deviation improvement in Business Sophistication rank from 55 in 2020 to 17 is expected to increase overall Innovation Output rank to 42 from 45 in 2020	• Intellectual Property payments as % of total trade (rank 27) • % of Firms offering formal training (rank 37) • Research talent, % in business enterprise (rank 38) • University/Industry research collaboration (rank 45) • % GERD financed by business (rank 48)	• % of Females employed with advanced degrees (rank 101) • FDI net inflows as % of GDP (rank 92) • % of Knowledge intensive employment (rank 90)

- Mere reliance on "Jugaad innovation" (makeshift solution) risks missing the crucial opportunity to innovate our way into the future.
- India must also focus on strengthening institutions and business sophistication to improve its performance on innovation outputs.
- More importance should be given to schemes like Startup India campaign that recognises entrepreneurship as an important strategy to fuel productivity.

9. JAY HO: AYUSHMAN BHARAT'S JAN AROGYA YOJANA (JAY) AND HEALTH OUTCOMES

Aim

To demonstrate the positive effects on healthcare outcomes of the Pradhan Mantri Jan Arogya Yojana

Need

- Public goods are not adequately provided for by the markets.

- Therefore, provisioning for public goods and ensuring their supply represents one of the most important functions of a government.
- Access to safe drinking water, sanitation, transport, medical care, and schools are essential both as a direct component of well-being as well as inputs into productive capabilities.

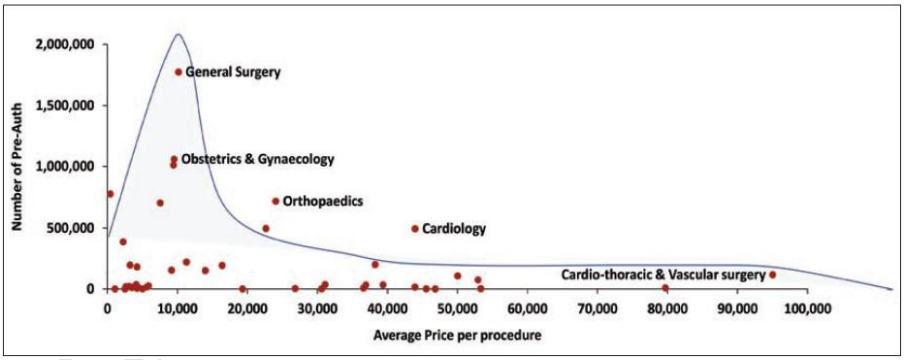
PM-JAY

- It was launched in 2018 to provide healthcare access of up to Rs. 5 lakh/family/year to the most vulnerable sections.
- It provides for secondary and tertiary hospitalization through a network of public and empanelled private healthcare providers.
- It also provides for three days of pre-hospitalization and 15 days of post-hospitalization expenses.
- It places no cap on age and gender, or size of a family and is portable across the country.
- It also aims to set up 150,000 health & wellness centres.
- It is provided on a family floater basis i.e it can be used by one or all members of the family.

Usage

- It is being used significantly for high frequency and low cost care consisting with the general utilisation of healthcare services. (common range of Rs.10,000-15,000)

Figure 1: The distribution in utilization of various procedures



- General medicine has been the overwhelmingly major clinical specialty used, among which **dialysis** accounts for 30%.

Impact of PM-JAY during Lockdown

- The claims for dialysis did not diminish due to Covid, indicating **users' reliance on PM-JAY**.
- Moreover the number of dialysis claims has only been growing. This highlights that the National Dialysis Mission could be merged with PM-JAY.
- General medicine exhibited a V-shaped recovery after falling during the lockdown.

Impact of PM-JAY on Public Health

- The proportion of households with health insurance increased by 54% for the states that implemented PM-JAY, while falling by 10% in states that did not.

Provisions	States that adopted PM-JAY	States that did not adopt PM-JAY
Health Insurance Coverage	Increased by 54%	Declined by 10%
Registered Pregnancies	Increased by 7%	Increased by 5%
IMR	Declined by 12%	Declined by 10%
Under-5 Mortality	Declined by 19%	Declined by 14%
Children receiving BCG	Increased by 5%	Declined by 1%
Using family planning methods	Increased by 15%	Increased by 7%
Unmet need between consecutive kids	Declined by 31%	Declined by 15%

**Women with unmet need are those who want to stop or delay childbearing but are not using any method of contraception.*

- While some of these effects stemmed directly from enhanced care due to insurance coverage, others represent spillover effects due to the same.
- Overall, the comparison reflects significant improvements in several health outcomes in states that implemented PM-JAY versus those that did not.
- However, the improvement in the delivery care indicators (like institutional births, institutional births in public facility, and home births) are much higher in the states which did not adopt the PM-JAY.

10. THE BARE NECESSITIES

Aim

This chapter aims to examine the progress made in providing access to "the bare necessities" by constructing a Bare Necessities Index (BNI) at the rural, urban and all India level.

Bare Necessities

- The bare necessities to live a decent life include housing, water, sanitation, electricity and clean cooking fuel.
- Access to these saves time for a household, which they can utilise in productive activities such as education and learning.

- Several schemes are designed to deliver these necessities include inter-alia the Swachh Bharat Mission, National Rural Drinking Water Programme, Pradhan Mantri Awaas Yojana, Saubhagya, and Ujjwala Yojana.

Bare Necessities Index

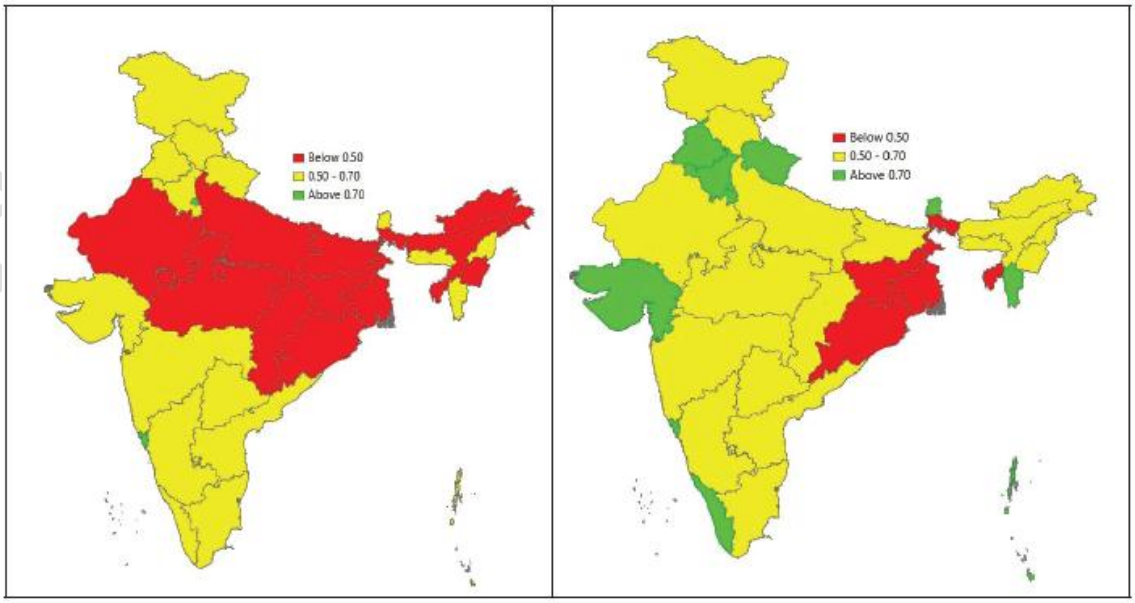
- BNI has 26 indicators on 5 dimensions viz., water, sanitation, housing, micro-environment & other facilities.
- BNI has been created for all states for 2012 and 2018 using data from two NSO rounds.
- Compared to 2012, access to "the bare necessities" has improved across all States in 2018.
- Inter-State disparities in the access to "the bare necessities" have declined in 2018 across rural and urban areas.
- Access to bare necessities is the highest in the States such as Kerala, Punjab, Haryana and Gujarat while it is the lowest in Odisha, Jharkhand, West Bengal and Tripura.
- Access to "the bare necessities" has improved disproportionately more for the poorest households when compared to the richest households across rural & urban areas.

Five Dimensions	Indicators Used
Water	1. Principal Source of Drinking Water 2. Distance to the Principal Source of Drinking Water 3. Method of Taking Water 4. Nature of Access
Sanitation	1. Access to Latrine 2. Type of Latrine
Housing	1. Condition of Structure 2. Type of Dwelling 3. *Pucca** or not
Micro-Environment	1. Drainage System 2. Problem of flies/mosquitoes 3. Effort was made by Government to tackle flies/mosquitoes
Other Facilities	1. Kitchen Type 2. Ventilation 3. Access to Bathroom 4. Type of Bathroom 5. Electricity 6. Type of Wiring 7. Type of Fuel for Cooking

**Pucca structure as defined in NSO report is a structure whose walls & roofs were made of pucca materials such ascement, concrete etc*

Figure 1: Improvement in the Bare Necessities Across India (Rural + Urban) from 2012 to 2018

BNI for India (Rural + Urban) 2012 BNI for India (Rural + Urban) 2018



Outcomes

Measure	Outcome
Swachh Bharat Mission	Decrease in Diarrhoea & Malaria
Clean Cooking Fuel & Separate Kitchen	Reduction in respiratory illnesses
Water Connection	Reduced water hauling and so improved girls' school attendance
Latrine in Schools	Increases enrolment of pubescent-age girls
Electrification	Increased learning time due to lighting
Overall positive BNI	**Increased gross enrolment ratio for class 9-10 & class 11-12**