59

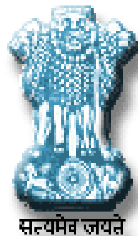
STANDING COMMITTEE ON FINANCE
(2011-12)

FIFTEENTH LOK SABHA

Ministry of Finance
(Department of Economic Affairs)

CURRENT ECONOMIC SITUATION AND POLICY OPTIONS

FIFTY- NINTH REPORT



LOK SABHA SECRETARIAT
NEW DELHI

August, 2012/ Bhadra, 1934 (Saka)

FIFTY- NINTH REPORT

STANDING COMMITTEE ON FINANCE
(2011-2012)

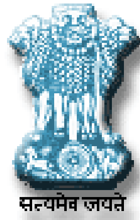
(FIFTEENTH LOK SABHA)

Ministry of Finance
(Department of Economic Affairs)

CURRENT ECONOMIC SITUATION AND POLICY OPTIONS

Presented to Lok Sabha on 30 August, 2012

Laid in Rajya Sabha on 30 August, 2012



LOK SABHA SECRETARIAT
NEW DELHI

August, 2012/ Bhadra, 1934 (Saka)

CONTENTS

Page No.

COMPOSITION OF THE COMMITTEE .... (iii)

INTRODUCTION .... (iv)

REPORT

PART I

I. Introduction 1

II. Global Economic Scenario 1

III. Indian Economy 2

IV. Challenges before the Indian Economy 30

V. Policy Stance 45

PART II

Recommendations/Observations 53

APPENDICES

I. Dissent notes submitted by Shri Gurudas Dasgupta, MP and Shri P. Rajeeve, MP 78

II. Minutes of the sittings of the Committee held on 7 June, 2012, 27 July, 2012, 6 August, 2012 and 28 August, 2012 82

COMPOSITION OF STANDING COMMITTEE ON FINANCE – 2011-12

Shri Yashwant Sinha - Chairman

MEMBERS

LOK SABHA

2. Shri Shivkumar Udasi
3. Shri Jayant Chaudhary
4. Shri Harishchandra Deoram Chavan
5. Shri Bhakta Charan Das
6. Shri Gurudas Dasgupta
7. Shri Nishikant Dubey
8. Shri Chandrakant Khaire
9. Shri Bhartruhari Mahtab
10. Shri Anjan Kumar Yadav M.
11. Shri Prem Das Rai
12. Dr. Kavuru Sambasiva Rao
13. Shri Rayapati S. Rao
14. Shri Magunta Sreenivasulu Reddy
15. Shri Sarvey Sathyanarayana
16. Shri G.M. Siddeswara
17. Shri N. Dharam Singh
18. Shri Yashvir Singh
19. Shri Manicka Tagore
20. Shri R. Thamaraiselvan
21. Dr. M. Thambidurai

RAJYA SABHA

22. Smt. Renuka Chowdhury*
23. Shri Ravi Shankar Prasad*
24. Shri Vijay Jawaharlal Darda
25. Shri Piyush Goyal
26. Shri P. Rajeeve *
27. Shri Satish Chandra Misra
28. Dr. Mahendra Prasad *
29. Dr. K.V.P. Ramachandra Rao
30. Shri Yogendra P. Trivedi
31. Shri Naresh Agrawal**

SECRETARIAT

1.	Shri A.K. Singh	-	Joint Secretary
2.	Shri R.K. Jain	-	Director
3.	Smt. Reena Gopalakrishnan	-	Deputy Secretary

---

*Nominated to be the Member of the Standing Committee on Finance w.e.f 4th May, 2012

Nominated to be the Member of the Standing Committee on Finance w.e.f 15th May, 2012

INTRODUCTION

I, the Chairman of the Standing Committee on Finance (2011-12), having been authorized by the Committee, present this Fifty-ninth Report on the 'Current Economic Situation and Policy Options'.

2. The Committee took evidence of the representatives of the Ministry of Finance on 7 June, 2012 and 27 July, 2012. The Committee also took evidence of the representatives of Reserve Bank of India on 6 August, 2012.

3. The Committee, at their sitting held on 28 August, 2012 considered and adopted the draft report and authorized the Chairman to finalise the same and present it to the Parliament.

4. The Committee wish to express their thanks to the officials of the Ministry of Finance and Reserve Bank of India for appearing before the Committee and furnishing the requisite material and information which were desired in connection with the examination of the subject.

5. For facility of reference, the observations/recommendations of the Committee have been printed in thick type in the body of the Report.

New Delhi;
28 August, 2012
6 Bhadra, 1934 (Saka)

YASHWANT SINHA
Chairman,
Standing Committee on Finance

REPORT

PART- I

CURRENT ECONOMIC SITUATION AND POLICY OPTIONS

I. Introduction

1.1 The growth of an economy is a complex phenomenon and it depends on a number of factors, both domestic and external factors. These factors can be broadly categorized into four major groups: (i) Initial conditions; (ii) Quantity of Inputs/Resources available; (iii) Efficiency with which the resources are utilized; and (iv) External factors. Initial conditions include factors like availability of natural resources, population, rainfall (monsoon), etc. From a macro point of view, quantity of inputs/resources available would include savings, investments, their composition, etc. These factors would, to a great extent, determine the capacity being created in an economy. The third category would include efficiency with which savings and investment get converted into output and it is here the Incremental Capital Output Ratio (ICOR) has a role in the macro-content. There are also a number of external factors that would determine the growth of an economy. These originate primarily from the interaction with the rest of world in the form of trade, foreign investment, apart from actions taken by rest of the world and their impact, etc. However, these factors are not mutually exclusive and interact with one another, and this interaction is often not in straight forward manner. Also, at different points of time, different factors play a role**.**

II. Global Economic Scenario

2.1 The global economy has been passing through a rather difficult phase and the developments over the last year in major economies of the world have not been encouraging. There is an apprehension that the process of global economic recovery that began after the financial crisis of 2008 is beginning to stall and the sovereign debt crisis in the euro-zone area may persist for a while**.**

2.2 According to the World Economic Outlook released by International Monetary Fund (IMF) in April 2012, the rate of growth in the global economy declined to 3.9 per cent in 2011 and is expected to decline further to 3.5 per cent in 2012 though the GDP growth in 2010 was 5.3 per cent. As far as advanced economies are concerned their rate of growth had halved from 3.2 per cent in 2010 to 1.6 per cent in 2011 and is expected to decline to 1.4 per cent in 2012. The Report also states that though some optimism has returned to the U.S. economy, the risk of another crisis is still very much present and could well affect both advanced and emerging economies. For emerging economies, the Report has projected sustained growth though they are not immune to export growth and financial uncertainty together with sharp shifts in risk appetite and the developments in the advanced economies. GDP growth in the emerging and developing economies is projected to slow from 6¼ percent in 2011 to 5¾ percent in 2012 but then, to reaccelerate to 6 percent in 2013, helped by easier macroeconomic policies and strengthening foreign demand**.**

2.3 The IMF's World Economic Outlook Update (July 2012) highlights that already sluggish global recovery shows signs of further weakness, mainly because of continuing financial problems in Europe and slower-than-expected growth in emerging economies. The global economy is projected to grow 3.5 per cent in 2012 and 3.9 per cent in 2013.

III. Indian Economy

(i) Historic perspective

3.1 In order to place the current state of affairs in the economic arena of the country in the correct perspective, it would be worthwhile to look into the growth of the Indian economy for long-term trends, particularly in the context of the post 1991 period and reflect upon at the current conjuncture. The rate of growth between 1950-51 and 1990-91 was 4.1 per cent. In contrast, between 1991-92 and 2011-12 the economy registered a growth of 6.9 per cent. While in the four decades from 1951-52 to 1991-92, the growth rate in terms of GDP at

factor cost (at 2004-05 prices) was more than 6 per cent only in 10 years; between 1992-93 and 2011-12, the growth rate has been over 6 per cent in as many as 14 years.

3.2 The growth rate has accelerated significantly since 2003-04. Between 2003-04 and 2011-12, the economy registered a growth of 8.2 per cent per annum. In fact, during this period, the growth rate has never fallen below 6.7 per cent and has been over 8 per cent in six of these nine years. All the three major sectors of the economy, namely agriculture, industry, and services witnessed higher-than-trend growth rates at 3.9 per cent, 8.0 per cent, and 9.6 per cent respectively. With the declining share of the agriculture sector and reasonably consistent growth in the services sector, the variations in growth rate of GDP are lately being associated with the variations in the industry sector.

3.3 This accelerated growth could partly be attributed to an increase in savings and investment rates, which averaged 33.1 per cent and 34.3 per cent respectively during the period between 2003-04 and 2010-11. The average savings and investment rates in the 1990s were 23.0 per cent and 24.3 per cent respectively. Higher growth rate resulted in fairly rapid increase in per capita income. It took nearly 40 years for the real per capita income to double from the level achieved in 1950-51. However, it increased 2.5 times in the next 20 years in the post-reforms period.

3.4 The contributions of the agriculture and allied sector, industry sector, and services sector also underwent significant changes overtime. The long-term growth rate of the agriculture sector (over the last 60 years) has been 2.7 per cent. It was 2.3 per cent between 1950-51 and 1980-81 and 3.1per cent during 1980-81 to 2011-12. Growth in the industry sector increased from 5.2 per cent in the earlier period to 6.4 per cent between 1980-81 and 2011-12. Similarly growth in the services sector was 4.4 per cent and 7.8 per cent respectively during these two sub-periods.

3.5 The structure of the economy has also undergone significant changes over time. Between 1950-51 and 1980-81, the industrial sector

registered a higher growth rate than the services sector. The converse has been the case since then. This resulted in the share of the industry sector in GDP increasing by around 9 percentage points from 16.6 per cent to 25.9 per cent during the period from 1950-51 to 1980-81. The share of the services sector increased from 30.3 per cent in 1950-51 to 38 per cent in 1980-81. It started growing rapidly thereafter and this phenomenon became more pronounced in the 1990s. Consequently, since 1980-81, the share of the industry sector has remained in the range of 26 to 28 per cent of GDP, while the entire decline in share of agriculture has been balanced by an increase in share of the services sector. Thus, the resilience of the economy to shocks owe to the services sector which has the largest share and most consistent growth performance. The changes in relative shares of these sectors in GDP are given in the table below:-

Sectoral Composition of GDP			
Year	Agriculture	Industry	Services
1950-51	53.1	16.6	30.3
1960-61	48.7	20.5	30.8
1970-71	42.3	24.0	33.8
1980-81	36.1	25.9	38.0
1990-91	29.6	27.7	42.7
2000-01	22.3	27.3	50.4
2010-11(QE)	14.5	27.8	57.7
2011-12(AE)	13.9	27.0	59.0

Source: Economic Survey 2011-12.

(ii) Current state of the Indian economy

3.6 The Ministry of Finance (Department of Economic Affairs) in a background note, *inter-alia,* informed the Committee about the current state of the Indian economy as under:-

"The Indian economy grew by 8.4 per cent in 2010-11 and is estimated to grow by 6.5 per cent during 2011-12 in terms of Gross Domestic Product(GDP) (at factor cost at constant 2004-05 prices). However, relative to a growth of over 8 per cent in the period 2003-04 to 2010-11 (with the

exception of 2008-09), the growth in 2011-12 is on the lower side. This is mainly due to the weakening industrial growth in the wake of persistent inflationary pressures and deterioration in the global economic situation.

Compression in aggregate demand was quite evident in 2011-12 as a result of Monetary policy tightening resorted to control inflation and inflationary expectations. The Reserve Bank of India (RBI) raised policy rates by 375 basis points between March 2010 and October 2011. The impact of tight monetary policy particularly gets reflected in the quarterly growth rates of GDP. Growth in each of the successive quarters of 2011-12 was lower than the previous quarter:-

Year	Q1	Q2	Q3	Q4
2010-11	8.5	7.6	8.2	9.2
2011-12	8.0	6.7	6.1	5.3

3.7 In this regard, the RBI in its background note, *inter-alia,* informed the Committee as follows:-

"*Domestic Developments: Output and Aggregate Demand*

- Domestically, GDP growth decelerated over four successive quarters from 9.2 per cent in Q4 of 2010-11 to 5.3 per cent in Q4 of 2011-12. Real GDP growth (factor cost and market prices) during the years 2010-11 and 2011-12 is given in the table below:-

Real GDP growth - Factor Cost and Market Prices

(Per cent)

Item	2010-11	2011-12	2010-11				2011-12			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10	11
GDP at factor cost	**8.4**	**6.5**	**8.5**	**7.6**	**8.2**	**9.2**	**8**	**6.7**	**6.1**	**5.3**
1. Agriculture	7.0	2.8	3.1	4.9	11	7.5	3.7	3.1	2.8	1.7
2. Industry	6.8	2.6	8.2	5.6	7.2	6.3	6.5	2.7	0.9	0.7
3. Services	9.2	8.5	9.8	8.7	7.8	10.4	9.3	8.5	8.7	7.5
GDP at market prices	**9.6**	**6.9**	**9.5**	**8.9**	**10**	**9.7**	**9**	**6.9**	**6.2**	**5.6**
I. Total Consumption Exp.	8.1	5.4	9.4	8.8	6.9	7.4	4.9	4.9	6.1	5.8
(i) Private	8.1	5.5	9.1	8.6	7.3	7.6	4.9	4.6	6.4	6.1
(ii) Government	7.8	5.1	11.1	10.5	4.7	6.7	4.9	7.2	4.7	4.1
II. GFCF	7.5	5.5	8.8	6.9	11.1	3.7	14.7	5	-0.3	3.6
III. Change in Stocks	37.4	2.4	39.4	35.5	37.7	37.1	7.1	2.8	0.4	-0.4
IV. Net Exports	5.5	-30.7	-35.4	-14.6	29.5	33.4	-23.2	-46.7	-117.9	117.8
V. Discrepancies	38.9	-112.7	-1.0	11.1	91.1	7.3	-51.8	-119.6	-152.0	-124.0

- The sharp slowdown in growth is largely attributable to the contraction in value added in the manufacturing sub-sector and deceleration in most services sub-sectors. The decline in investment, particularly private corporate investment, has emerged as a major drag on the demand side.

Industrial slowdown intensifies

- Growth in the Index of Industrial Production (IIP) moderated sharply to 0.8 per cent during April-May 2012 as compared with 5.7 per cent during April-May 2011. The slowdown in growth was reflected across all sectors. The mining sector continued to decline mainly due to regulatory and environmental issues affecting coal mining and the low output of natural gas from the Krishna-Godavari (KG) basin. By the use-based classification, moderation in growth is seen in all categories except consumer durables. The declining domestic production of capital goods has been partly substituted by increase in capital goods imports. However, domestic production of capital goods has also suffered in the backdrop of the weak investment environment…...

Signs of Moderation in the Services sector

- Services growth is also showing signs of slowing in line with slowing industrial growth and weak global economy. Various lead indicators of the services sector point towards deceleration in growth

Weakness in Aggregate Demand Continues

- On the demand side, the GDP growth decelerated to 6.9 per cent in 2011-12 as compared with 9.6 per cent in 2010-11. Significant weakness in investment activity was the main cause of the slowdown. Growth in private consumption also decelerated in 2011-12, even as it remained the key driver of growth. The slowdown in consumption demand also points towards the impact of high and persistent inflation on purchasing power.
- The subdued levels of investment activity can be partly attributed to high interest rates but non-monetary factors have played a more significant role. Apart from the erosion in corporate profit margins and already high leverage, other domestic and global factors have contributed to weakening investment activity. The share of public investment in GDP has also declined. With the large and growing revenue deficit constraining the fiscal space for investment expenditure, the capital outlay to GDP ratio declined to 1.6 per cent, well below the pre-crisis level of over 2 per cent.

Likely overshooting of subsidies pose fiscal risks during 2012-13

- The compensation to oil marketing companies for under-recoveries budgeted at Rs.400 billion for 2012-13 appears inadequate, given the spillover in compensation of Rs.385 billion in Q4 of 2011-12 and under-recoveries of Rs.478 billion reported by oil marketing companies for Q1 of 2012-13, in spite of some softening of global crude oil prices.

State finances budgeted to improve further in 2012-13

- In contrast to the Centre, the consolidated revenue account of the States (excluding Mizoram and Manipur) showed a marginal surplus in 2011-12 as compared with the revenue balance in 2010-11. Key Fiscal Indicators are given in the table below:-

Key Fiscal Indicators

(As per cent to GDP)

Year	Primary Deficit	Revenue Deficit	Gross Fiscal Deficit	Outstanding Liabilities@
1	2	3	4	5
Centre				
2010-11	1.8	3.3	4.9	52.8
2011-12 RE	2.8	4.5	5.9	51.9
	(2.7)	(4.3)	(5.8)	
2012-13 BE	1.9	3.4	5.1	–
States*				
2010-11	0.5	-0.0	2.1	23.3
2011-12 RE	0.8	-0.1	2.3	22.3
2012-13 BE	0.6	-0.4	2.1	21.0
Combined*				
2010-11	2.4	3.2	6.9	65.8
2011-12 RE	3.6	4.4	8.2	65.4
2012-13 BE	2.6	3.1	7.1	–

RE: Revised Estimates. BE: Budget Estimates.
@: Includes external debt at current exchange rates.
*: Data in respect of States pertains to 26 State Governments.
Note: Figures in parentheses are provisional accounts.
Source: Budget documents of the Central and State Governments.

3.8 On being asked about the impact of global economic factors, for instance, crude oil price movement, on the domestic economy, the written reply as furnished by the Ministry of Finance (Department of Economic Affairs) is given below:-

"Global slowdown due to unfolding of euro zone sovereign debt crisis has, *inter-alia*, impacted the Indian economy through financial and trade channels in the form of a deceleration in exports, widening of trade and current account deficits, decline in capital flows, fall in the value of Indian Rupee and a decline in equity markets. The impact on the real economy has been through the changes in movements in export and import of goods and services. While there has been a slowdown in exports arising from the slowdown in the Euro-zone economies, imports had remained high on account of the firm global commodity prices. This coupled with domestic factors like elevated headline inflation and the tight monetary

policy to control inflationary pressures entailed a slowdown in the real GDP growth".

3.9 In this context, the RBI stated as follows:-

…Global growth and trade volume are now expected to be lower than projected earlier. Given the greater integration of the Indian economy with the global economy, this will have an adverse impact on growth, particularly in industry and the services sector".

3.10 The Governor, RBI, who deposed before the Committee further added as under:-

"Over the last few months, the macroeconomic situation both at home and around the world, have deteriorated. Much of the global economy is in a synchronised slowdown, having lost the upward momentum seen in the early months of the year. Despite the slowing global economy, the outlook for commodity prices is uncertain………...

…..there are three macroeconomic challenges for the economy. First is managing the growth inflation dynamics. Second is fiscal consolidation and the third is managing the external sector. As all of you know, these challenges are inter-connected….".

3.11 The Country witnessed similar economic slowdown in the years 1998 and 2008. Asked to apprise the Committee on how the Indian economy was revived then, and the difference with the current situation, the Ministry of Finance (Department of Economic Affairs) in a post-evidence reply responded as follows:-

"The global financial crisis of 2008 impacted the Indian economy directly through financial and trade channels and led to a slowdown in aggregate demand. Growth in GDP at constant prices at factor cost moderated from level above 9 per cent in the preceding three years to 6.7 per cent in 2008-09 mainly on account of a deficient monsoon induced slowdown in agriculture and moderation in industry owing to tight monetary policy stance then to control inflation immediately prior to the collapse of M/s Lehman Bros. However, the impact was felt most acutely on the demand side (expenditure side GDP). Growth in GDP at market prices (current prices) fell from a level of over 16 per cent each in 2006-07 and 2007-08 to 12.9 per cent in 2008-09. In terms of GDP at market prices at constant prices, growth was over 9 per cent in each of the three years preceding 2008-09 and fell to 3.9 per cent in 2008-09. The fall in aggregate demand was due to a short fall in investment demand and a moderation in real

private final consumption expenditure. In order to obviate slowdown in aggregate demand, fiscal packages comprising of expenditure hikes and tax cuts were effected to boost demand. Monetary policy rates were progressively reduced to provide support for demand revival as inflation that was driven by global commodity prices in the first half of 2008-09 moderated significantly in the second half following a crash in global commodity prices.

In 2010-11 while GDP growth at constant prices at factor cost was 8.4 per cent, growth at constant market prices was 9.6 per cent; in terms of current prices growth in the GDP at factor cost was 17.5 per cent and growth in market prices was 18.8 per cent reflecting the sharp uptick in nominal GDP due to high inflation. Unlike 2008-09 when there was sufficient space to accommodate a fiscal expansion in a non-inflationary manner (as inflation fell due to weak demand) then, there is very limited fiscal space in the current conjecture and there is still strong demand and high inflation. In fact, monetary policy is in a tightening mode to dampen these elevated levels of aggregate demand to control inflation and anchor inflationary expectations. While the eurozone crisis and slowdown in some advanced economies in the current conjecture has had impact on financial and trade channels, there has been no major crash in global commodity prices and with domestic demand continuing to be high, the same set of policy mix of monetary accommodation and fiscal expansion is not a sustainable option.

In terms of financial sector transmission, the situation in the two time periods i.e. 2008-09 and current conjecture are somewhat different. In 2008-09, there was a freezing of global money markets and drying up of capital flows into India which put pressure on domestic and foreign currency liquidity position. Financial markets were helped by the accommodative policies then and the rupee recovered faster then owing to sharper decline in imports *vis-a-vis* exports. In the current conjecture, monetary policy has remained tight to control inflationary pressure and current account deficit has widened sharply reaching 4.2 per cent of GDP in 2011-12, which has led to the sharper depreciation of the rupee in the wake of less than adequate financing of the same by capital flows affected as they are by the euro-zone crisis".

3.12 Some key economic parameters are discussed below:-

a) Gross Domestic Product (GDP) Growth

The Gross Domestic Product (GDP) growth rate provides an aggregated measure of changes in value of the goods and services produced by an economy and our economy has posted an average growth of 7 per cent in the decade since 1997.

3.13 The Economic Survey (2011-12) highlighted about the slowdown as under:-

> "…..With the exception of the year 2008-09 when the growth rate was 6.7 per cent, the growth in real GDP in 2011-12 has been the lowest in nine years. This speaks well of the last nine years but must also be treated as a wake-up call. Like in 2008-09, a part of the reason for the slowdown lies in global factors, particularly the crisis in the euro-zone area and near-recessionary conditions prevailing in Europe; sluggish growth in many other industrialized countries, like the USA; stagnation in Japan; and hardening international prices of crude oil, which always has a large effect on India. Domestic factors, namely the tightening of monetary policy, in particular raising the repo rate in order to control inflation and anchor inflationary expectations, resulted in some slowing down of investment and growth, particularly in the industrial sector. Since monetary policy operates largely through demand compression in the short run, the expectation is that this policy will in fact bolster long-run growth. The 2008-09 downturn came to India when the country's fiscal balances were robust. Hence, there was ample scope for fiscal and monetary stimulus. As in most parts of the world, this second slowdown is coming so quickly on the heels of the previous one that the latitude that we have in terms of fiscal and monetary policy is much more limited. Evidently, there is need to be innovative in terms of policy…...
>
> ***…..***There is no doubt that a part of India's slowdown is rooted in domestic causes. The persistent inflation that remained over 9 per cent for much of the year and needed to be tamed played a role. There were also the pressures of democratic politics, which slowed reforms. Keeping these factors in view, it seems reasonable to endorse the CSO's AE of 6.9 per cent growth for this year. Calculations based on tracking several statistical indicators and projections of incremental capital-output ratios lead to a forecast of the growth rate of real GDP for 2012- 13 to be 7.6 (+/-0.25) per cent……"

3.14 However, the Committee have been informed that the Indian Economy could be able to achieve 6.5 per cent of GDP in the year 2011-12 as against the estimate of 8.5 per cent. Regarding the economic slowdown in the year 2011-12, the Ministry of Finance (Department of Economic Affairs) submitted the following:-

> "……the slump in growth in 2011-12 is mainly on account of the slowdown in the industrial sector that is expected to register a growth rate of 3.4 per cent in 2011-12 as against 7.2 per cent in 2010-11 and lower growth of 2.8 per cent in agriculture sector in 2011-12 on top of a high growth rate of 7 per cent achieved in 2010-11. Services sector registered a growth of 8.9 per cent in 2011-12, which is also on the lower side as compared to a growth of 9.3 achieved in 2010-11.
>
> The slowdown in the economy can be attributed both to domestic and global factors. Global factors include, in particular, the crisis in the euro-zone area and near-recessionary conditions prevailing in Europe; slow growth in many other industrialized countries, hardening of international prices of crude oil, etc. Domestic factors, namely the tightening of monetary policy, in order to control inflation resulted in slowing down of investment and growth, particularly in the industrial sector. In the wake of higher inflation, there is hardly a scope for fiscal and monetary stimulus in the current situation that was available to combat the slowdown in 2008-09."

3.15 About the prospects for the year 2012-13, the Ministry further submitted:

> "…… There are signs that indicate that the growth rate in 2012-13 would be higher than what is likely in 2011-12. In the recent months inflation has been exhibiting downward trends. Further easing of inflation could lead to some more reversal of tight monetary measures taken by the RBI, which could encourage investment activity. As fiscal consolidation gets back on track, savings and investment should also increase. These factors should result in growth consolidating in 2012-13. As a result, it would be reasonable to expect the growth rate of real GDP for 2012-13 to be 7.6 (+/-0.25) per cent. It may be mentioned that these projections are contingent on conditions like normal rainfall, reasonably stable prices of petroleum products, global economics situation, etc.".

3.16 The RBI, however, expressed its view in this regard as under:-

"Economic activity slowed down considerably during Q4 of 2011-12 and has likely stayed weak during Q1 of 2012-13. Growth in 2012-13 is likely to remain below potential. Newer risks to growth have arisen from slowing global trade, domestic supply bottlenecks of industrial inputs, coal and electricity and less-than-satisfactory monsoon so far. Services growth is also showing signs of slowing in line with slowing industrial growth and weak global economy".

3.17 Expressing optimistic hopes about a turn around in the economy, the Chief Economic Advisor stated before the Committee as below:

"One thing we have to be clear is that there is a slow down, but we are nowhere near a stagflation. Last year's growth of 6.5 per cent is still pretty handsome growth. It is just that we got so used to very good performance all the way from 2003 till 2008 that it is looking very poor. But, yes, the slow down is something, which should not have happened, and we should take up position for better performance. But we are not in a stagflationary situation.

….for this year 2012-13,……7.6 per cent growth……is not unrealistic and we have seen these kinds of step-ups because in 2008-09 growth had dropped to 6.7 and then it shot up to 8.4. So from 6.5 to 7.6 is very doable".

3.18 On a specific query regarding the widening inequalities and disparity of wealth in our society and the need to revisit neo-liberal economic policies, the RBI in a post evidence reply submitted as below:

"Official estimates of below poverty line (BPL) and average monthly household consumption expenditures (MPCE) are the two indicators of marginalization, inequality and purchasing power. As per the 66th Round of NSS data on Household Consumption Expenditure Survey for 2009-10, the all India poverty ratio declined by 7.3 per cent from 37.2 per cent in 2004-05 to 29.8 per cent in 2009-10. Rural poverty ratio declined by 8.0 per cent from 41.8 per cent to 33.8 per cent and urban poverty declined by 4.8 per cent from 25.5 per cent to 20.9 per cent.

Table : Poverty Estimates: 2004-05 and 2009-10

Estimates	Rural	Urban	Total
Tendulkar Committee (2004-05)			
Poverty Line (Rs. Per capita per month)	446.7	578.8	-
Number of Poor (million)	325.8	81.4	407.2

Percentage of Poor	41.8	25.5	37.2
Tendulkar Committee (2009-10)			
Poverty Line (Rs. Per capita per month)	672.8	859.6	-
Number of Poor (million)	278.2	76.4	354.7
Percentage of Poor	33.8	20.9	29.8

The rate of reduction in poverty has accelerated considerably after 2004-05 and the rate of reduction in the five years between 2004-05 and 2009-10 is about 1.5 per cent per year; twice as fast as the rate of reduction in the previous eleven years, i.e., 1993-94 to 2004-05 (Table below).

Table : Reduction in Poverty

Year of NSS survey	Rural	Urban	Total
1993-94	50.1	31.8	45.3
2004-05	41.8	25.7	37.2
2009-10	33.8	20.9	29.8
Reduction Rate 1993-94 to 2004-05 (per year)	0.8	0.6	0.7
Reduction Rate 2004-05 to 2009-10 (per year)	1.6	1	1.5

The values of average MPCE for NSS 68th , 66th and 61st rounds at all-India rural and urban levels at 2004-05 prices has also been increasing steadily over the period (Table below).

Table : Average MPCE

URP at 2004-05 prices

Rs

NSS Rounds	Rural	Urban
68th Round (July 2011-June 2012	707.24	1359.75
66th Round (July 2009-June 2010)	599.06	1200.01
61st Round (July 2004-June2005)	558.78	1052.36

The largest numbers of poor, primarily landless workers still lived in rural areas and the majority of them still rely on farm work for their livelihood. However, during the period 2007-10 (calendar years), the average real wage rates increased by 16.0 per cent at the all India level. The growth was the fastest in Andhra Pradesh (42%) and Orissa (33%). Even in states like Bihar and Uttar Pradesh, real farm wages went up by 19 and 20 per cent respectively, over the three year period. This is expected to help raise purchasing power in rural areas. Further, the 12th Five Year Plan has

identified twelve flagship programmes to boost the effort of inclusive and reduce poverty during 2012-17. Some of these programmes are the MGNREGA, Rastriya Kridhi Vikash Yojana (RKVY), Sarva Sikcha Abhiyan (SSA), Indara Iwas Yojana (IAY), Mid-day Meal Scheme (MDM). In this regard, early implementation of the National Food Security Bill (NFSB) is expected to further help bridge the existing gaps of purchasing power, inequality and poverty.

The reforms in the financial sector since 1990s have been guided by the need to improve economic functioning primarily from the standpoint of enhancing the efficiency and effectiveness of resource allocation. The liberalization and deregulation of financial markets was done gradually and in a calibrated manner for smooth economic transition and without any external or multilateral influence. Although the process of reforms is yet unfinished but has led to huge improvement in the productive potential of the economy and stability of the financial system. Apart from the overall economic reforms, the Reserve Bank continues to give priority for achieving low and stable inflation recognising the adverse welfare impact of high inflation on the poor. Recent initiatives of the Reserve Bank to promote financial inclusion are also aimed at making development more inclusive."

3.19 The Committee find from the provisional results of the 68th round National Sample Survey (July 2011-June 2012) of household consumer expenditure as below:

"The average MPCEURP in 2011-12 was estimated at Rs.1281.45 in rural India and Rs.2401.68 in urban India. Thus the per capita expenditure level of the urban population was on the average about 87.4% higher than that of the rural population.

- The poorest 10% of India's rural population had an average MPCEURP of Rs.503.49. The poorest 10% of the urban population had an average MPCEURP of Rs.702.26.
- The top 10% of the rural population, ranked by MPCEURP, had an average MPCEURP of Rs. 3459.77, about 6.9 times that of the bottom 10%. The top 10% of the urban population had an average MPCEURP of Rs. 7651.68, about 10.9 times that of the bottom 10%.
- In rural India, half of the population belonged to households with MPCEURP below Rs.1030 (median value) and nearly 40% of the rural population of India had MPCEURP below Rs.922. About 60% of rural population had MPCEURP below Rs. 1162. About 10% had MPCEURP above Rs.2054.
- In urban areas of India, half of the population was living with MPCEURP below Rs.1759, about 70% of population had MPCE

above Rs1295, nearly 30% had MPCE above Rs. 2464, and 20% had MPCE above Rs.3077."

b) Savings and Investment

3.20 Savings and investment have been considered as two critical macroeconomic variables with microeconomic foundations for achieving price stability and promoting employment opportunities thereby contributing to sustainable economic growth. Economists often claim that higher savings contribute to increased investment and GDP growth in a country.

3.21 Key Ratio of savings and investment to GDP (at current market prices per cent) is given in the table below:-

	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10 PE	2010-11 QE
Gross Domestic Saving	32.4	33.4	34.6	36.8	32.0	33.8	32.3
Public Sector	2.3	2.4	3.6	5.0	1.0	0.2	1.7
Private Sector	30.1	31.0	31.0	31.8	31.1	33.6	30.6
Household Sector	23.6	23.5	23.2	22.4	23.6	25.4	22.8
Financial Saving	10.1	11.9	11.3	11.6	10.1	12.9	10.0
Gross Capital formation (Investment)	32.8	34.7	35.7	38.1	34.3	36.6	35.1
Public Sector	7.4	7.9	8.3	8.9	9.4	9.2	8.8
Private Sector	23.8	25.2	26.4	28.1	24.8	25.2	24.9
Corporate Sector	10.3	13.6	14.5	17.3	11.3	12.7	12.1
Household Sector	13.4	11.7	11.9	10.8	13.5	12.4	12.8
Gross Fixed Capital formation	28.7	30.3	31.3	32.9	32.3	31.6	30.4
Saving-investment gap	-0.4	-1.3	-1.1	-1.3	-2.3	-2.8	-2.8
Public sector	-5.1	-5.5	-4.7	-3.9	-8.5	-9.0	-7.1
Private sector	6.3	5.8	4.6	3.7	6.3	8.5	5.8

3.22 The savings and investment scenario in the country as narrated in the Economic Survey (2011-12) is furnished below:-.

"…The reduction in the financial savings rate of households could be partly attributable to inflationary tendencies in the economy during the period that resulted in higher growth of private final consumption expenditure than of personal disposable income and partly to a reduction in real interest rate. During 2011-12, the growth of investment in the Indian economy is estimated to have registered a significant decline. This has been on account of a sharp increase in the policy rates that resulted in higher costs of borrowings. There was a reduction in investment rates, both in the public and private sectors, particularly the corporate sector, in 2010-11. Reduction in corporate investment could be attributed to global factors, with the global economy exhibiting signs of slowing down in the second half of 2010 as well as to domestic factors, namely increased cost of borrowing following the raising of interest rates in order to control inflation. Fixed investment as a ratio of GDP peaked in 2007-8 and has continued to register a decline since then, falling from 31.6 per cent in 2009-10 to 30.4 per cent in 2010-11.

At 2.8 per cent of GDP, the savings-investment gap during 2010-11 remained at the same level as in 2009-10. This reflected the need to finance the investment requirement from foreign savings (current account deficit). The gap, in excess of 2 per cent of GDP, has been at relatively elevated levels (since 2008-09), as compared to 0.4-1.3 per cent in 2004-05 to 2007-08……..the fiscal stimulus provided in order to overcome the slowdown of 2008-09 reduced public savings as a ratio of GDP by 4 percentage points in 2008-09 and another 0.8 percentage points in 2009-10. The increase in the revenue levels, thanks partly to substantial increase in non-tax revenue receipts in the year 2010-11, and the process of fiscal consolidation were among the factors responsible for narrowing of the public sector's savings-investment gap.

In the medium to long term, growth of an emerging economy depends, to a large extent, not only on overall level of investment but also on its sectoral composition reflecting the transformation taking place. However, annual growth rates of investment both at aggregate and sectoral levels may vary, depending on expectations of profitability, sales, etc.

Some sectoral Investment growth rates (at 2004-05 prices) is given in the table below:-

Rates of Growth of GCF (per cent)						
	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Agriculture	13.9	5.9	15.9	21.4	2.8	8.4
Mining & quarrying	40.0	15.7	13.1	-16.6	15.7	6.7
Manufacturing	17.5	17.2	29.0	-31.3	42.3	7.1
Electricity, gas and water supply	21.3	18.1	12.6	15.1	3.3	1.0
Constructions	5.7	66.5	20.2	23.1	-2.5	14.1
Transport, storage and communication	20.1	-6.7	25.3	53.8	-7.5	2.2
Railways	14.6	12.9	13.7	22.5	6.2	-9.5
Storage	-285.9	18.0	5.7	71.9	-8.0	13.3
Communication	33.2	-6.7	29.3	110.6	-2.9	-2.4

As can be seen from the table, there are large scale variations in the growth rates of sectors over time. Most of the sectors in 2010-11 registered positive growth in real terms in investment levels except communications and railways. The marginal negative growth in communications in 2009- 10 and 2010-11 is not surprising after the very high growth in this sector in the previous two years. The growth in real investment in railways turned negative after showing a positive trend for several years. This partly reflects the inability to raise tariffs in order to meet increasing expenditures".

3.23 Regarding Gross Domestic Fixed Capital Formation(GDFCF), the Report of the Economic Advisory Council to Prime Minister released in August, 2012, states as follows:-

" Gross Domestic Fixed Capital Formation(GDFCF) as a proportion GDP has continued to decline, falling from its highest level of 32.9 per cent in 2007-08, to 30.4 per cent in 2010-11 and as per initial estimates for 2011-12 to 29.5 per cent. Clearly there has been a significant weakening in the pace of fixed asset creation (GDFCF/GDP) by as much as 3.4 percentage points of GDP. This is a significantly large number, since its counterpart in terms of the potential reduction in the rate of growth of the economy, is about 0.8-0.9 percentage points".

3.24 The Ministry of Finance (Department of Economic Affairs) in a post-evidence reply further stated that:-

"While there may be a decline in rate of savings in 2011-12, ……tentative estimates which are indicative in nature suggest a positive turn in Q4 as detailed below:

Current Prices		GDP MP	Investment	Savings	Investment	Savings
		(Rs in crore)			Rate of Growth	
	Q1	1,717,201	629,663	527,571		
	Q2	1,760,513	669,930	556,644		
	Q3	2,015,000	706,914	645,434		
2010-11	Q4	2,181,432	742,683	701,041		
	Q1	2,041,548	772,987	641,756	22.8	21.6
	Q2	2,052,146	772,096	593,049	15.3	6.5
	Q3	2,314,104	776,550	576,605	9.9	-10.7
2011-12	Q4	2,447,999	823,958	872,486	10.9	24.5
2004-5 prices						
	Q1	1,208,714	466,498	374,192		
	Q2	1,226,451	495,442	394,322		
	Q3	1,353,279	515,581	442,070		
2010-11	Q4	1,448,382	538,317	489,020		
	Q1	1,317,379	529,957	416,204	13.6	11.2
	Q2	1,311,143	520,733	372,424	5.1	-5.6
	Q3	1,437,717	515,274	355,127	-0.1	-19.7
2011-12	Q4	1,529,618	557,509	566,280	3.6	15.8

Source: CSO, MoSPI

3.25 With respect to savings factor, the Secretary, Ministry of Finance (Department of Economic Affairs) during the course of oral evidence stated as under:

> "…On the savings side, we do have to say that from 36.8 in 2007-08 to 32.3 in 2010-11 there has been a decline. Corporate savings is one which has gone down from 9.4 per cent in 2007-08 to 7.9 per cent in 2010-11. The household savings have also gone down from 25.4 in 2009-10 to 22.8 in 2010-11. The important factor to note is that the financial savings of the households is one of the issues we need to take care of. Inflation is one of the reasons why there was some moderation in financial savings for the households….. Our estimates for 2011-12 is that it will be 31.5."

3.26 The Secretary, Ministry of Finance (Department of Economic Affairs) further submitted as follows:-

> "…..there are two factors which are really showing certain signs of vibrancy and also hope for good measure of growth increase. One is the savings factor……In 2011-12, it could be down by 31.5…..But if we take

that as the base and look at the fourth quarter of last year, it has shown a very high growth of 24.5 per cent at current prices and 15.8 per cent on constant prices. With the kind of savings numbers as we are now seeing with Incremental Capital Output Ratio presumed to be constant at about 4, there is bound to be a good growth in excess of 7 that are likely to happen……Two things are required for that to happen. One is the existing manufacturing capacity which is not being fully utilised has to move up and second is new capacity addition or new capacity creation taking place. These are functions of number of factors. The factors would include the inflow of capital into the country, the exchange rate, the foreign direct investment and inflation as the factors".

3.27 However, the Governor, RBI commented on the Investment factor as follows:-

"On the growth side, there is additional risk coming……..mainly from the slowdown in investment… For the last four quarters, we have seen decline in investment. In the third quarter of last fiscal year, investment as actually negative. Investment today is tomorrow's capacity to produce. So, if today investment has declined, we are compromising not only on today's growth prospects but growth prospects in the medium term".

c) Agricultural sector

3.28 The average annual growth in agriculture and allied sectors realized during the first four years of the Eleventh Plan Period, i.e. 2007-08 to 2010-11, is 3.3 per cent against the targeted growth rate of 4 per cent due to severe drought experienced in most parts of the country during 2009-10 and drought/deficient rainfall in some states, namely Bihar, Jharkhand, eastern UP and West Bengal in 2010-11. However, growth in agriculture and allied sectors reached 7.0 per cent in 2010-11, the highest growth rate achieved during the last six years.

3.29 The Ministry of Finance in a background note submitted to the Committee stated as under:-

"Growth in agriculture and allied sectors is estimated at 2.5 per cent in financial year 2011-12(Advance Estimate). Driven by an increase in the rice and wheat, production of food grains is estimated at an all-time record level of 252.56 million tonnes in 2011-12 (Third Advance Estimate) as against a high level of 244.78 million tonnes in 2010-11. Thus, while

growth in 2011-12 might be lower than the previous year; this has been achieved against a high base level. While the above indicates some improvement in the levels of production in recent years, growth in agriculture and allied sectors have fallen short of the Plan targets. Given the obvious limitations in expansion of area under crops, growth in agriculture primarily depends on yields in crops. This has been sought to be achieved through productivity gains and technology diffusion across regions. Important factors affecting this are the level of gross capital formulation in agriculture. The proportion of gross capital formation (at constant 2004-05 prices) to the value added in agriculture sector rose to 20.1 per cent in 2010-11 from a level of 13.5 per cent in 2004-05. However, the share of agriculture and allied sector's gross capital formation in overall gross capital formation of the economy has exhibited a mixed trend. Government has also strived to enhance the flow of credit to agriculture sector, and in recent years actual credit to agriculture sector exceeded the targets set in this regard".

3.30 Outlining the steps taken by the Government to pep up the sector, the Secretary, Ministry of Finance (Department of Economic Affairs) during oral evidence submitted as under:-

"On the agriculture sector, we have a number of schemes which we had announced in the Budget; a lot of work has gone on. The National Dairy Plan Phase-1 with a total outlay of Rs.2242 crore will be implemented; that has been cleared. Now, this will provide advisory services to about 2.7 million milch animals at the doorstep; it will focus on fodder seed production, grazing land improvement, production of green fodder – they will be added; they are the components of this".

d) Industry and Manufacturing

3.31 In a background note submitted to the Committee, the Ministry of Finance (Department of Economic Affairs), *inter-alia,* stated the following on industrial growth:-

"….Industrial growth, measured in terms of Index of Industrial Production (IIP), shows fluctuating trends. Growth had reached 15.5 per cent in 2007-08 and then started decelerating. Initial deceleration in industrial growth was largely on account of the global economic meltdown. Overall industrial growth……remained negative from December, 2008 to June, 2009. However, due to timely intervention and the stimulus measures adopted by the Government, there was a recovery in the industrial growth. Overall industrial growth improved to 8.2 per cent in 2010-11 compared to 2.5 per cent in 2008-09 and 5.3 per cent in 2009-10.

Fragile global economic recovery and subdued domestic sentiments, however, resulted in the moderation of growth during 2011-12. The index for eight core industries (comprising crude oil, petroleum refinery products, coal, electricity, cement, steel, natural gas and fertilizers) with a weight of 37.9 per cent in the IIP registered an increase of 4.4 per cent in 2011-12, as compared to growth rate of 6.6 per cent achieved in 2010-11…".

3.32 The growth in industry as furnished by the Ministry in a post-evidence written reply is as below:-

2009-10	2010-11	2011-12
8.4	7.2	3.4

3.33 In another post-evidence reply, the Ministry of Finance (Department of Economic Affairs) submitted the trend on industrial sector during the current fiscal as under:-

"As per the quick estimates of IIP, the overall growth of the industrial sector during April-May 2012 had been 0.8% as compared to 5.7% during April-May 2011. The slowdown in industry is due to combination of domestic and external factors. Higher borrowing cost, infrastructure bottlenecks, decline in investment and exports have contributed towards the lower growth of industry. The Government has initiated several steps to attract investment into infrastructure sectors and has laid special emphasis to augment the supply of critical inputs. The emphasis is in building positive investment climate and stepping up the performance of the mining sector which provides critical inputs such as coal, iron ore and natural gas.

Moderation in manufacturing sector has been due to domestic supply constraints, weak business sentiment resulting in lower investment and slowdown in exports. The government has initiated steps to boost production of key inputs. Efforts to boost the business sentiment and build positive climate are being made. The Budget 2012-13 focused on creating conditions for rapid revival of high growth in private investment and addressing supply bottlenecks in agriculture, energy and transport sectors, particularly in coal, power, national highways, railways and civil aviation".

3.34 The Ministry of Statistics and Programme Implementation (MOSPI) has been monitoring the progress of all central-sector projects costing Rs 150 crore and above. The flash report for the month of May, 2012 tracks the progress

of 564 projects in different sectors. Of these, only 3 are ahead of schedule, 133 are on schedule, and 251 are delayed (177 projects were sanctioned without specifying any commissioning schedule). The delays also imply a cost overrun of 19.5 per cent (Rs.1,43,042.97 crore) with respect to original cost. The maximum number of projects delayed belong to road transport and highways (84), followed by petroleum (41), railways (36), power (28), coal (26) and shipping & port (10).

3.35 The Committee, however, find from the latest IIP data released on August 9, 2012 by the Central Statistical Office (CSO) for June, 2012 as under:-

> "The General Index for the month of June 2012 stands at 168.3, which is 1.8% lower as compared to the level in the month of June 2011. The cumulative growth for the period April-June 2012-13 stands at (-)0.1% over the corresponding period of the previous year.
>
> The Indices of Industrial Production for the Mining, Manufacturing and Electricity sectors for the month of June 2012 stand at 124.3, 178.1 and 157.0 respectively, with the corresponding growth rates of 0.6%, (-)3.2% and 8.8% as compared to June 2011. The cumulative growth in the three sectors during April-June 2012-13 over the corresponding period of 2011-12 has been (-) 1.1%, (-)0.7% and 6.4% respectively."

Financial markets

3.36 The Economic Survey (2011-12), *inter-alia,* stated on financial markets as given below:-

> "Financial markets in India have acquired greater depth and liquidity over the years. Steady reforms since 1991 have led to growing linkages and integration of the Indian economy and its financial system with the global economy. Weak global economic prospects and continuing uncertainties in the international financial markets therefore have had their impact on the emerging market economies. Sovereign risk concerns, particularly in the euro area, affected financial markets for the greater part of the year, with the contagion of Greece's sovereign debt problem spreading to India and other economies by way of higher-than-normal levels of volatility. The funding constraints in international financial markets could impact both the availability and cost of foreign funding for banks and corporates. Since the Indian financial system is bank dominated, banks' ability to withstand stress is critical to overall financial stability. Indian banks, however, remain robust, notwithstanding a decline in capital to risk-weighted assets ratio and a rise in non-performing asset levels in the recent past. Capital

adequacy levels remain above the regulatory requirements. The financial market infrastructure continues to function without any major disruption. With further globalization, consolidation, deregulation, and diversification of the financial system, the banking business may become more complex and riskier. Issues like risk and liquidity management and enhancing skill therefore assume greater significance."

3.37 The RBI in its Financial Stability Report, June, 2012 highlighted, among other things, the following:-

"The stability of the banking sector deteriorated marginally in the period since September 2011. The soundness indicators of banks, however, remained robust. Asset quality pressures persisted while credit growth decelerated, largely reflecting the slowdown in the economy. As the divergence between credit and deposit growth widened, banks' reliance on borrowed funds increased, heightening associated liquidity risks. Going into 2012-13, the operating conditions for the Indian banks are expected to remain challenging given the weakening global economic outlook, adverse domestic macroeconomic conditions and policy uncertainties. Banks in India are likely to be affected due to deleveraging in advanced countries though the direct impact is expected to be limited. Credit growth of the non banking financial companies has decelerated. Regulatory restrains have been put in place to rein in the risks posed by exposure of banks to gold loan companies. The stress tests carried out on banks, incorporating a range of shocks, revealed deterioration in their capital position as compared with the baseline scenario, but the banking system remained resilient even under extreme stress scenarios."

e) Services sector

3.38 The Services sector has been a major and vital force steadily driving growth in the Indian economy for more than a decade. The share of services in India's GDP at factor cost (at current prices) increased from 33.5 per cent in 1950-51 to 55.1 per cent in 2010-11 and to 56.3 per cent in 2011-12 as per Advance Estimates (AE). If construction is also included, the service sector's share increases to 63.3 per cent in 2010-11 and 64.4 per cent in 2011-12.

3.39 The Economic Survey (2011-12), *inter-alia,* highlighted the services growth prospects as follows:-

"…..In 2010-11 and 2011-12, there is a slight moderation in services growth. This is mainly due to the steep fall in growth of public administration and defence services, creating some fiscal space for the government. Growth in trade, hotels, and restaurants is more robust at 11.2 per cent. If interest rates remain elevated, there would be some

concern about growth in real estate, ownership of dwellings, and business services which has started decelerating. The outlook for some of the services in the economy is also linked to the global prospects. While software services exports have continued to be steady, the unfolding events in the euro area could lead to some sluggishness in this sector….".

3.40 The relative consistency of performance of service sector over other sectors over the years can be seen from the data furnished by the Ministry in a post-evidence written reply:-

GDP Growth	2009-10	2010-11	2011-12
Agriculture Industry Services	1.0 8.4 10.5	7.0 7.2 9.3	2.8 3.4 8.9
Export growth of Services	-9.6	38.7	7.1

f) External Sector

3.41 Selected indicators of the External Sector are given in the table below:-

Item	2006-07	2007-08	2008-09	2009-10	2010-11	2010-11 H1 PR	2011-12 H1 P
Growth of exports – BoP %	22.6	28.9	13.7	-3.5	37.3	30.0	40.6
Growth of Imports – BoP %	21.4	35.1	19.8	-2.6	26.7	27.3	34.3
As per cent of GDP							
Exports	13.6	13.4	15.2	13.4	14.8	13.9	16.6
Imports	20.1	20.8	25.0	22.0	22.6	22.8	25.8
Trade Balance	-6.5	-7.4	-9.7	-8.7	-7.8	-8.9	-.94
Invisibile balance	5.5	6.1	7.5	5.9	5.0	5.1	-9.4
ECBs	1.7	1.8	0.6	0.1	0.7	0.7	1.2
FDI (net)	0.8	1.3	1.8	1.3	0.6	0.9	1.3
Portfolio Investment (Net)	0.7	2.2	-1.2	2.4	1.8	3.1	0.1
Total Capital Account	4.7	8.6	0.5	3.8	3.7	5.0	4.5

(Net)								

3.42 The resilience of India's trade can be seen from the fact that the growth of exports and imports, which was (-)3.5 per cent and (-)5 per cent respectively in 2009-10 as a result of the 2008 global economic crisis, rebounded to 40.5 per cent and 28.2 per cent in 2010-11. India not only reached pre-crisis levels in exports but also surpassed pre-crisis trends in export growth rate, unlike many other developing and even developed countries. India's share in global exports and imports also increased from 0.7 per cent and 0.8 per cent respectively in 2000 to 1.5 per cent and 2.2 per cent in 2010.

3.43 India has made progress in diversifying its export and import markets. The share of Asia and the Association of South East Asian Nations (ASEAN) in total trade increased from 33.3 per cent in 2000-01 to 57.3 per cent in the first half of 2011-12, while that of Europe and America fell from 26.8 per cent to 19 per cent. This has helped India weather the global crisis emanating from Europe and America. The USA has been displaced by the UAE as India's largest trading partner, followed by China, since 2008-09.

3.44 The Ministry of Finance (Department of Economic Affairs) in its background note informed the following:-

> "On a Balance of Payment (BoP) basis, merchandise exports of US$ 309.8 billion recorded a growth of 23.6 per cent, year-on-year, during 2011-12 as compared with 37.5 per cent (US$ 250.6 billion) in 2010-11. Imports of US$ 499.5 billion registered a growth of 31.1 per cent during 2011-12 as compared with 26.7 per cent (US$ 381.1 billion) in 2010-11, mainly reflecting higher imports of Petroleum Oil and Lubricant (POL) and gold & silver. With export growth remaining lower than the import growth, the trade deficit widened to US$ 189.7 billion (10.3 per cent of GDP) in 2011-12 as compared to US$ 130.4 billion (7.7 per cent of GDP) in 2010-11, showing a y-o-y increase of 45.5 per cent…….
>
> During 2012-13 (April-May), exports (customs basis) at US $ 50.1 billion, were (-) 0.7 per cent lower than the level of US $ 50.5 billion in 2011-12 (April-May). Export growth in May 2012 declined to (-) 4.2 percent. Imports were valued at US $ 80 billion in (April-May, 2012) and these were 2.4 per cent lower than the level of US $ 81.9 billion in 2011-12 (April-May). Import growth in May 2011 also declined to (-) 7.4 per cent. POL imports during 2012-13 (April-May) were US $ 28.9 billion, registering a

growth of 10.5 per cent over US $ 26.1 billion in 2011-12 (April-May). POL imports growth in May 2011 increased by 14 percent. Non-POL imports during 2012-13 (April-May), at US $ 51 billion, were 8.5 per cent lower than the level of US $ 55.7 billion in 2011-12 (April-May). Gold & Silver imports valued at US $ 7.5 billion during 2012-13 (April-May), declined by 45.5 per cent compared to corresponding period of the previous year. Trade Deficit for 2012-13 (April-May) was US $ 29.8 billion which was 5.2 percent lower than the imports of US $ 31.4 billion in 2011-12 (April-May)".

3.45 The RBI, *inter*-alia, informed on External Sector as under:-

"On the external sector front, India's merchandise exports, which had decelerated in 2011-12, contracted in Q1 of 2012-13 mainly reflecting subdued demand conditions in key global markets, particularly the EU and the US. Evidently the significant depreciation in the rupee since the second half of 2011-12 could not sufficiently offset the impact of the slowdown in global demand. The rising trend of imports reversed in Q1 of 2012-13. The decline in imports in Q1 of 2012-13 was more than the decline in exports in the quarter mainly on account of a modest contraction in POL imports and a significant contraction in gold and silver imports. Softening of international commodity prices also helped in narrowing the trade deficit.

The recent trend of faster deceleration in imports than exports has given rise to the possibility that the current account deficit (CAD) could improve in 2012-13 although the upside risk to CAD remain significant. Downside risks to export growth are large in view of worsening global conditions.

Since Q1 of 2012-13, concerns about the growth and financial health of euro area countries have further intensified. Capital flows may remain volatile due to global uncertainties. Concerns about the domestic business environment appear to be weighing on FDI inflows as well. Further, increasing external debt is turning out to be a concern. Thus, there is a pressing need to improve the equity flows to finance CAD and maintain the external debt at a manageable level".

3.46 However, according to the media reports, the exports and imports of India further declined in the month of July, 2012. The details are given below:-

	July, 2011 (In $ bn)	July, 2012 (In $ bn)	Rise / Fall (in %)
Exports	26.3	22.4	-14.8
Imports	41.1	37.9	-7.8
Balance of trade	14.8	15.5	

3.47 The Economic Survey (2011-12), *inter-alia,* dealt with challenges and outlook on international trade as follows:-

> "While India has successfully diversified its markets with reduced dependence on the EU and US, Europe still has a 19.5 per cent share in India's exports. Besides, some of India's trading partners are dependent on Europe, thus affecting India's trade indirectly……..
>
> Recent import figures also indicate a fall not only in imports of the EU, but also imports of other Asian and South East Asian countries like China, Hong Kong, and Singapore……..
>
> ……..Performance of software exports could largely depend on the developments in the major economies like the US, UK, and major euro area economies. While the US accounts for nearly 60 per cent of India's software exports, the EU economies account for around 30 per cent. However, there is no significant exposure to the countries which are presently facing crisis. To that extent, there may not be a significant loss of business for Indian software companies. Nevertheless, software exports may show some sluggishness. The euro zone accounts for around 30 per cent of total tourist arrivals in India and travel exports may also suffer because of lower tourist arrivals from the euro zone particularly the affected countries…….
>
> ……..The challenges in the medium and long term are the following. While India is less vulnerable to the situation in the US, EU, and other developed countries due to its diversification of exports to Asia and ASEAN, concerns have increased on the bilateral trade deficit front with India's high and growing trade deficits with countries like China and Switzerland. A lot more needs to be done on diversification of India's export basket as its export presence is limited in the top items of world trade……".

FDI and FII

3.48 On FDI inflows, the Economic Survey (2011-12), *inter-alia,* stated as under:-

> "…..Inward FDI showed a declining trend while outward FDI showed an increasing trend in 2010-11 vis-a-vis 2009-10. Inward FDI declined from US$ 33.1 billion in 2009-10 to US$ 25.9 billion in 2010- 11. Sector-wise, deceleration during 2010-11 was mainly on account of lower FDI inflows under manufacturing, financial services, electricity, and construction. Country-wise, investment routed through Mauritius remained the largest component of FDI inflows to India in 2010-11 followed by Singapore and

the Netherlands. Outward FDI increased from US$ 15.1 billion in 2009-10 to US$ 16.5 billion in 2010-11. With lower inward FDI and rise in outward FDI, net FDI (inward minus outward) to India stood considerably lower at US$ 9.4 billion during 2010-11 (US$ 18.0 billion a year earlier).

As per the latest available information on capital inflows, FDI inflows were US$ 35.3 billion during April-December 2011 (US$ 16.0 billion in the corresponding period of the preceding year). Portfolio inflows fell sharply to US$ 3.3 billion during April-December 2011 from US$ 31.3 billion a year earlier mainly reflecting uncertainty and risk in the global economy on account of the euro zone crisis….".

3.49 The Ministry of Finance (Department of Economic Affairs) in its background note stated as follows:-

"Net capital inflows were higher at US$ 67.8 billion (3.7 per cent of GDP) in 2011-12 as compared to US$ 62.0 billion (3.7 per cent of GDP) in previous year. Net FDI inflows of US$ 22.1 billion and NRIs deposits at US$ 11.9 billion were higher in 2011-12 vis–a-vis US$ 9.4 billion and US$ 3.2 billion respectively in 2010-11. Portfolio net flows slowed down to US$ 16.6 billion in 2011-12 from US$ 28.2 billion in 2010-11. There was a drawdown of foreign exchange reserves (on BoP basis) to the extent of US$ 12.8 billion during 2011-12 as against an accretion of US$ 13.1 billion in 2010-11".

3.50 While discussing about foreign investment in the country, the Committee pointed out that FIIs form a major part of foreign investment and this increases speculation in the sector. Asked whether the Ministry is ready to tighten this field, the Ministry in a written reply stated as follows:-

"FIIs inflows were US$ 16.8 billion during 2011-12, as against US$ 29.4 billion in 2010-11. In the current fiscal 2012-13, however, there was FIIs outflow of US$ 1.3 billion in the month of April 2012 vis-a-vis FIIs inflow of US$ 3.4 billion in April 2011. Investment flows in equities were liberalized as a part of economic reforms and have helped the economies external financing needs. A part of the FII flows could be speculative in nature, which imparts some volatility in both equities and FOREX markets. Even in the immediate aftermath of the global financial crisis, FII flows were bidirectional, which indicate the mature nature of the equities market and that the outlook of the economy remains strong. Net FII inflows might be negative in phases arising from the relative returns for the global investors across the world".

3.51 During oral evidence, the Chief Economic Advisor submitted as under:-

> "……..this is the time of some gloom, but foreign direct investment last year was the record, 46.8 billion dollars. The previous record was 41 point some billion dollars. So, the world is investing in India in a huge way, huge step –up. I think that is a mood up lifter…..".

3.52 To a specific query raised by the Committee as to whether despite the economic crisis that the world is facing, India has been insulated and the flow of FDI remains higher or even constant, the Chief Economic Advisor replied as under:-

> "I will accept. There is a bit of a puzzle about this very sharp increase which took place. One possible thing is that because of the climate going down in the rest of the world, some of the money is finding its way here. There is another thing possible. In fact, I have noted here, which actually strikes a chord to me that FII and FDI have to be treated very differently.
>
> ….. the FII, the short-term flows are not doing so well but the world around betting on India is still high. So, the foreign direct investment is indeed doing well into India….".

3.53 In this regard, the Secretary, Ministry of Finance (Department of Economic Affairs) submitted before the Committee as follows:-

> "………A number of steps have been taken for attracting FII flows into the country. We will be improving on them as we go along. We would also be taking some more steps to see how debt flows can come into the country. With the overall improvement, it is possible to attract more foreign direct investment. In fact, last year, despite whatever was being talked about, was the year when we had the highest foreign direct investment gross flows into the country in the history of India…….".

3.54 Asked to respond to a statement that India's growth story is based on domestic saving and domestic demand and external demands like exports and external supports like FDIs and FIIs have played only a marginal role in the liberalized scenario, the Ministry in a post-evidence reply stated as under:-

> "……bulk of the investment demand of the economy has been financed by domestic savings, with foreign savings accounting for 1.2 per cent of GDP over 2003-04 and 2010-11. However, the role of foreign flows in the recent

years has increased. India now counts as one of the major destinations for FDI. Inflow of additional resources in the form of FDI and FII is crucial to finance India's huge investment requirement for infrastructure development. However, India has followed a calibrated approach to capital flows that has, to a significant extent, prevented volatility.

The net investment (Equity+Debt) made by FIIs during the last three financial years is as under:

(Amount in INR crore)

Financial Year	Gross Purchases	Gross Sales	Net Investment	Cumulative Net Investment
2009-10	8,46,438	7,03,780	1,42,658	1,42,658
2010-11	9,92,599	8,46,161	1,46,438	2,89,096
2011-12	9,21,285	8,27,562	93,725	3,82,821

Source-SEBI

3.55 However, the Committee find from the RBI's monthly bulletin of August, 2012 that the FDI inflows have dipped by over 50 per cent in Q1 of 2012-13 compared to the Q1 of 2011-12. The details are as below:-

	Q1 of 2011-12 (April-June) (in $ bn)	Q1 of 2012-13 (April-June) (in $ bn)	% fall
FDI inflows	12.2	5.6	54.1
FDI outflows	3.1	1.8	41.9
Net FDI	9.1	3.8	58.2

IV. Challenges before the economy

a) Inflation

4.1 In the background note submitted to the Committee, the Ministry of Finance (Department of Economic Affairs) stated about the current price situation as follows:-

"The headline WPI inflation during financial year 2011-12 averaged 8.9 per cent as compared to 9.6 per cent during 2010-11. After almost two years of sustained high inflation, it began to moderate from December 2011. The recent fall in inflation has been largely due to a seasonal decline in vegetable prices and a favourable base effect. Headline

inflation, which had reached 10 per cent in September 2011, declined to 7.7 per cent by March 2012. The financial year 2012-13 has started with a 7.2 per cent WPI inflation in April 2012 which increased to 7.5 per cent in May 2012.

The average WPI food inflation comprising primary food articles and manufactured food products, with a weight of 24.31 per cent, declined to 7.2 per cent during 2011-12 compared to 11.1 per cent during 2010-11. On a yearly average basis, inflation for protein products softened to around 10 per cent in 2011-12 compared to around 20 per cent in the preceding two years. The protein based food inflation had declined to a single digit level during March, 2011 to August, 2011 after reaching a peak of around 34 per cent in May 2010. However, from September 2011, it has continued to be at double-digit levels.

Besides a lagged supply response, input cost pressures have led to the persistence of double-digit inflation in protein-rich food items. Recognising the importance of supply-augmenting measures to address the concerns about food inflation, the government in the Union Budget for 2012-13 has announced a number of measures to augment supply and improve storage and warehousing facilities. These supply-side measures will help in containing food inflation but the overall benefits are expected to be realised only with a lag….".

4.2 Year-on-year Inflation rate (per cent) is given in the table below:-

Year-on-year Inflation Rate (per cent)

	Jun-11	Jan-12	Feb-12	Mar-12	Apr-12	May-12 P	Jun-12 P
1	**2**	3	4	5	6	7	8
WPI - All Commodities	9.5	7.2	7.6	7.7	7.5	7.5	7.3
WPI - Primary Articles	11.3	2.8	7.1	10.4	9.6	10.9	10.5
WPI - Food Articles	7.6	-0.7	6.1	10.1	10.9	10.7	10.8
WPI - Fuel Group	12.9	17.0	15.1	12.8	12.1	11.5	10.3
WPI - Manufactured Products	7.9	6.7	5.8	5.2	5.3	5.0	5.0
WPI – Manuf. Food Products	8.8	5.5	5.6	6.2	6.4	5.9	5.8
WPI – Food Items (Food Articles + Food Products)	8.0	1.5	5.9	8.7	9.3	9.0	9.0
WPI – Essential Commodities #	10.8	4.1	5.6	6.7	8.2	7.8	7.5
WPI- Excluding Food Articles & Food Products	10.1	9.5	8.2	7.3	6.8	7.0	6.6
WPI - Excluding Fuel	8.9	5.5	6.2	6.7	6.6	6.8	6.7
WPI – Excl. Food Articles & Fuel	9.3	7.2	6.2	5.9	5.5	5.8	5.6
WPI - Manufactured Products (excl. Food Products)	7.7	7.0	5.9	5.0	5.1	4.8	4.8

Consumer Price Index (CPIs)							
(New) CPI- Rural	-	7.3	8.4	8.7	9.7	9.6	9.7
(New) CPI- Urban	-	8.3	9.5	10.3	11.1	11.5	10.4
(New) CPI- Combined	-	7.7	8.8	9.4	10.3	10.4	10.0
(New) CPI- Rural (Core)*	-	10.8	10.3	9.6	9.2	8.7	8.8
(New) CPI- Urban (Core) *	-	15.2	12.7	11.8	11.5	11.6	8.0
(New) CPI- Combined (Core)*	-	12.4	11.4	10.8	10.2	10.0	8.6
CPI - Industrial Workers	8.6	5.3	7.6	8.6	10.2	10.2	10.1
CPI - Agricultural Labourers	9.3	4.9	6.3	6.8	7.8	7.8	8.0
CPI - Rural Labourers	9.1	5.3	6.7	7.2	8.0	8.1	8.5

P : Provisional

Essential commodities (weight in WPI: 15.7 per cent) include rice wheat, jowar, bajra, pulses, potatoes, onions, milk, fish-inland, mutton, chillies (dry), tea, coking coal, kerosene, atta, sugar, gur, salt, hydrogenated vanaspati, rape & mustard oil, coconut oil, groundnut oil, cotton yarn, cotton cloth finished/processed, washing soap and safety matches.

* Excluding food items and fuel

4.3 On the price situation, the RBI added as under:-

"……The slow progress of the south-west monsoon so far and the uncertainty about its quantum as well as spatial and temporal distribution has emerged as a major risk to food inflation in the near-term…….However, the price pressures from the MSP continue to remain a major risk to inflation as the increases in MSP tend to translate into increases in market prices for most commodities.

…….However, the reversal in crude oil prices in recent weeks may add to domestic inflationary pressure. Also, the Oil Marketing Companies (OMCs) decided to implement the revised structure of 'state specific cost' with effect from July 24/25, 2012 to adjust for irrecoverable state taxes. This has led to changes in prices of petrol, diesel, kerosene and LPG across different States.

Administered prices have not been revised for more than a year and therefore, risks to fuel inflation continue to remain significant. Though price adjustments will exert inflationary pressures in the near term, the risk to medium-term price stability from a widening fiscal deficit should be addressed by adjustment of prices in line with market conditions.

Non-food manufactured products inflation was at 4.8 per cent in May and June 2012. Even though non-food manufactured products inflation declined in recent months, it still remains higher than the decadal average of 4.0 per cent during the 2000s. Also, core inflation in India in the recent period has been much higher than in advanced economies and emerging developing economies.

The momentum indicator of non-food manufactured products inflation (seasonally adjusted 3-month moving average annualised inflation rate)

showed an upturn. Apart from the pressure from global price trends and exchange rate movements, domestic constraints on supplies of key inputs like minerals and coal could also be a source of pressure on prices. These trends also indicate that the supply-side pressures do translate to generalised inflation through the input cost channel………

Consumer Price Index (CPI new series) inflation remained in double-digits in Q1 of 2012-13, driven by both food and non-food prices. The divergence between WPI and CPI inflation was on account of two factors. First, there are differences in the composition and weights of commodities, especially of food items in the two indices. Second, even in respect of similar items, inflation was higher in CPI than in WPI, suggesting that besides the incidence of higher service taxes, moderation in non-food manufactured products prices has not yet been transmitted to the retail level. The rate of increase in the prices of services, which is included in CPI but not in WPI, was also high".

4.4 During the course of oral evidence, the Governor, RBI further explained the price situation as follows:-

"As regards inflation, headline WPI inflation increased from 7.5 per cent in April to 7.6 per cent in May before marginally moderating to 7.3 per cent in June. You must also note that in the recent period WPI inflation was near ten per cent in April-November 2011. The headline WPI inflation increased from 7.5 per cent in April to 7.6 per cent in May, before moderating to 7.3 per cent in June, 2012.
This stickiness in inflation, despite the significant growth slowdown, was largely on account of high primary food inflation which was in double digits in the first quarter of this year, driven by a spike in vegetable prices, some of the vegetable prices have increased by as much as 50 per cent and sustained high inflation in protein items.

In April, the Reserve Bank's base-line projection of WPI inflation for March 2013 was 6.5 per cent. However, since then several upside risks have emerged on account of the deficient monsoon, elevated crude prices, rupee depreciation, suppressed inflation and input price pressures on account of exchange rate movement and infrastructure bottlenecks. Taking all these factors into account, the Reserve Bank raised its base-line projection for WPI inflation for March 2013 from 6.5 to 7 per cent….."

4.5 According to the Office of the Economic Adviser, Ministry of Commerce and Industry, the WPI inflation for July, 2012 fell to a 32 month low of 6.87 per cent year-on-year; fuel inflation declined to a two-year low of 5.98 per cent year-on-year, down from 10.27 per cent in June, 2012; food inflation

dropped to 10.06 per cent from 10.8 per cent and 6 per cent month-on-month drop in vegetable prices. It has also been given that a major fall in WPI is almost entirely due to a 3.3 per cent month-on-month fall in the fuel index and high base effect; non-inclusion of the rise in onion (15 per cent) and potato(12 per cent) prices. The numbers have not reflected the recent rise in sugar prices.

4.6 On being asked as to whether the country is heading towards stagflation, the Governor, RBI replied, among other things, as under:--

> "…..a stagflation situation. That is a matter of judgment. When you have low growth, coupled with high inflation over an extended period, that is stagflation. The question is whether we have had this for a long enough period and for reasons which are strong enough to term this as stagflation. Again, our judgment is that this is not stagflation because the world around us is in a deep crisis; three quarters of the world is not growing at all. Europe is in a recession. So, because of the extraordinary world situation, our growth has taken a beating. There are other factors. But it has also partly to do with our external situation….".

Subsidies and Inflation

4.7 On a specific issue raised by the Committee about the impact on inflation, if subsidies are adjusted, the Governor, RBI responded during oral evidence as follows:-

> "….It is the Reserve Bank's position that subsidies must be adjusted in the interest of fiscal consolidation and in the interest of encouraging efficient use of scarce resources. Under the broad assumptions that the price of oil will be about USD 100 a barrel on an average for the current year and the average exchange rate will be Rs. 53 to a dollar based on that, and after adjustment of subsidies, if the full adjustment is done then that will impact headline inflation by about 2.6 percentage points. That is the first order impact and then as that runs through the system, there will be additional inflationary impact. Perhaps the Government will not make a complete adjustment; that looks unlikely. But even if they make a sizeable adjustment, it will have an inflationary impact. Notwithstanding that inflationary impact, we believe that fiscal adjustment is important because fiscal adjustment or fiscal looseness has a lot of maladies. One of them is the pressure it puts on inflation but it also disrupts the macroeconomic stability. If prices are not adjusted, it is not as if there is no pressure on inflation because if prices are not adjusted, fiscal deficit will remain high and it will put pressure on inflation from the fiscal deficit side. So, it is not

as if we are escaping the inflationary impact of non-adjustment of oil prices."

Threshold level of Inflation

4.8 On being asked about the threshold level of inflation, the Governor, RBI during oral evidence stated:-

……in the Economic Survey of last year; not this year; saying that perhaps the Reserve Bank can opt for higher inflation by easing their monetary policy and thereby also get a higher growth…….. in the Reserve Bank's view, it is important and necessary that we have a higher rate of growth but a low and steady inflation rather than high growth and high inflation, which is not in the interest of the economy.

………the growth estimates has come down from 7.3 per cent to 6.5 per cent, and the inflation estimate had gone up from 6.5 per cent to 7 per cent………these are neutral assessments. Notwithstanding that, there are several risks. First there is the inflation risk. There is risk coming from monsoon uncertainty. Deficient monsoon impacts inflation more than it impacts growth. It will impact growth but perhaps marginally because agriculture is only about 14 per cent of GDP. So, even if agriculture growth comes down, growth will not be impacted that much. But inflation will be impacted first because of inflation expectations and second because of increase in prices of some commodities; not so much of grain but oilseeds, pulses and some of the minor grains such as jowar etc. which are grown in the rainfall deficit areas of central India and Rajasthan. The deficit monsoon will also probably increase drought related expenditure, especially on NREGS. So that will put pressure on the fiscal deficit and therefore put pressure on the inflation situation.

What is compounding the food inflation outlook in the country is that food outlook around the world is also under pressure because of drought in the US; international prices are under pressure. Even though our borders are sealed as far as food is concerned, there will be some transmission of those pressures to the domestic prices.

Then the NREGA wages are indexed to inflation. So, if inflation remains firm, wage pressures, and to that extent inflation pressures, will be exacerbated. Then there is pressure coming from commodity prices, especially the price of oil……. We saw it coming down from about 125 dollars in March to about 92 dollars in June. But since then, it has been inching up again. Now it is about 100 dollars. On top of that, the rupee has depreciated more than other currencies. Together with the rupee depreciation, the benefit of decline in oil prices has been offset. So the rupee depreciation has largely offset the benefit of decline in the global price of oil.

Finally, ……there is suppressed inflation in coal, in the power sector, in the electricity sector. So, these are all risks to our inflation”.

Growth *vs* Inflation

4.9 To a specific query about the Growth-Inflation link and its impact on the economy, the Governor, RBI during oral evidence explained to the Committee as follows:-

"……First of all, I would say that because of the Reserve Bank's tightening over the last two years, there has certainly been some sacrifices of growth and that cannot be disputed; and we admit to that. But I would also argue that that sacrifice in growth was both unavoidable and necessary. When inflation is as high as 10 per cent, you cannot bring it down without tightening monetary policy and the intent of monetary policy is to constrain demand. If you constrain demand, growth will go down. So, there was some sacrifice of growth. But our position is that bringing down inflation is important, necessary for securing medium-term growth. You might sacrifice some growth in the short-term….So, you have to provide them a stable inflation regime so that investment and consumption take place”.

b) Fiscal Consolidation

(i) Fiscal Deficit

4.10 The Ministry of Finance (Department of Economic Affairs) submitted the following on fiscal deficit:-

“With resumption of fiscal consolidation process in budget 2012-13, the government seeks to bring down fiscal deficit to 5.1 per cent of GDP in BE 2012-13 from 5.9 per cent of GDP in RE 2011-12. This reduction in fiscal deficit by 0.8 percentage point is to be largely revenue driven. Increase in tax revenue and non-tax revenue is of the order of 0.5 percentage point and 0.2 percentage point of GDP respectively. Government is committed to continue the process of fiscal consolidation during 2013-14 and 2014-15 with fiscal deficit projected to decline to 4.5 per cent of GDP in 2013-14 and 3.9 per cent of GDP in 2014-15. At the same time, effective revenue deficit is projected to decline from 1.8 per cent of GDP in BE 2012-13 to 1 per cent of GDP in 2013-14 and get eliminated in 2014-15.

To keep the overall expenditure under the estimated level, the Budget for 2012-13 proposed to control the growth of expenditure in subsidies and other related items. The issue of burgeoning expenditure on subsidies is being addressed by capping the expenditure on central subsidies to under 2 per cent of GDP in 2012-13 and in the next three years it would be further brought down to 1.75 per cent of GDP. Decision of the Government on move towards nutrient based subsidy (NBS) regime in fertiliser is

expected to reduce expenditure on this component of fertiliser subsidy during 2011-12. At the same time, NBS regime is also expected to promote balanced use of fertilizer leading to increase in agricultural productivity. Budget 2012-13 has proposed amendments in FRBM Act which would give statutory recognition of the concept of effective revenue deficit which reflects the structural component of imbalance in the revenue account and it is mandated to be eliminated by 2014-15. The provision for 'Medium–term Expenditure Framework Statement' also proposed through FRBM amendment would enhance efficiencies in expenditure management and would improve the quality of public expenditure".

4.11 In this regard, the Economic Survey (2011-12) emphasized the following:-

"…In the interest of medium- to long-term growth, it is important for us to bring the fiscal deficit down. While an expanded deficit can boost consumption and economic growth, this is medicine akin to antibiotics. It is very effective if properly used and in limited doses, but can cause harm if used over a prolonged period. Hence, government's aim must be to effect rapid fiscal consolidation. A large deficit over a long period tends to squeeze out the private sector from the credit space. This dampens private investment and productivity and, more significantly, worsens the options of the inflation-growth mix available to government……. if we want to keep inflation down and post robust growth, we have to aim for rapid fiscal consolidation….".

4.12 On fiscal deficit, the RBI suggested the following:-

"Fiscal and monetary space to stimulate the economy remain limited in the presence of an already large fiscal deficit and persistent inflation. The fiscal deficit target for 2012-13 is at a risk of being breached due to likely overshooting of subsidies and shortfall in receipts. To address this risk, fiscal space needs to be created by curtailing subsidies and significantly boosting government capital expenditures to provide an investment stimulus to the economy, which would help crowd-in private investment".

4.13 There is a large Government borrowing programme in the year 2012-13 in view of the high fiscal deficit. To a specific query as to how the recent SLR reduction from 24 per cent to 23 per cent of NDTL with effect from August11, 2012 would impact the Government's borrowing programme, the Governor, RBI responded as follows:-

"….The gross borrowing of the Government this year is about 5.7 trillion rupees, that is Rs. 5.7 lakh crore. That borrowing programme is on track

as per the calendar that we released. The yields are also very stable at about 8.1 per cent now. However, there is certainly no doubt that the very high demand from the Government has to some extent crowded out credit to the private sector. When we ask banks, they say there is no demand for credit. But there is no demand for credit at the current rates of interest. If banks indeed reduce the rates of interest, there would be demand. Banks are not able to do that because they have this option of lending to the Government. So it is very important that the Government maintain its commitment to the fiscal deficit target of 5.1 per cent. Hopefully, with the SLR reduction, credit will now flow, especially to the less organised small and medium sector and the unorganised sector".

ii) Current Account Deficit

4.14 The Ministry of Finance (Department of Economic Affairs) in its background note stated on Current Account Deficit (CAD) as follows:-

"The Current Account Deficit (CAD) widened both in absolute terms as well as a proportion of GDP in 2011-12, reflecting mainly widening of trade deficit on account of subdued external demand and relatively inelastic imports of POL and gold & silver. The CAD in 2011-12 at US$ 78.2 billion was 4.2 per cent of GDP as compared to US$ 46.0 billion accounting for 2.7 per cent of GDP in 2010-11.

Net capital inflows were higher at US$ 67.8 billion (3.7 per cent of GDP) in 2011-12 as compared to US$ 62.0 billion (3.7 per cent of GDP) in previous year. Net FDI inflows of US$ 22.1 billion and NRIs deposits at US$ 11.9 billion were higher in 2011-12 vis–a-vis US$ 9.4 billion and US$ 3.2 billion respectively in 2010-11. Portfolio net flows slowed down to US$ 16.6 billion in 2011-12 from US$ 28.2 billion in 2010-11. There was a drawdown of foreign exchange reserves (on BoP basis) to the extent of US$ 12.8 billion during 2011-12 as against an accretion of US$ 13.1 billion in 2010-11".

4.15 On the issue of fiscal consolidation, the Governor, RBI briefed the Committee as follows:-

"In 2011-12, that is, last year, the current account deficit was 4.2 per cent of GDP, rose from 2.7 per cent in the year before that, largely reflecting a higher trade deficit on account of subdued external demand and relatively inelastic imports of petroleum, oil and lubricants as well as gold and silver………. But this year we expect that current account deficit would soften a little bit, partly because of the softening of the oil prices and partly because the appetite for gold import has also softened a bit. So, actually for the first three months of this year, the non-oil and non-gold trade deficit has declined from the first quarter of last year. So, we see some decline in imports which is good from the current account deficit's point of view but

not necessarily good from the economy's point of view because we want the economy to continue to import of capital goods for investment. We want some efficiency parameters to kick-in in economising the use of diesel and petrol. So, an increase in prices to that extent will reduce the pressure on the current account deficit".

4.16 On CAD, the RBI suggested the following in a brief note:-

"The CAD-GDP ratio was an all time high of 4.2 per cent in 2011-12. Such a high level of CAD, especially against the backdrop of volatile global macroeconomic conditions and volatile capital flows, raises grave concerns about its sustainability. A recent analysis shows that with GDP growth of 7 per cent, a CAD-GDP ratio of around 2.5 per cent is sustainable. With an increase in deficit beyond this level, financing could be a constraint and the external sector vulnerability may rise further. Going forward, the trend in CAD will largely depend on the global macroeconomic and trade environment…..

….Softening of global crude oil prices and moderation of gold imports may bring some relief to the balance of payments, but CAD risks remain significant for 2012-13. Slowing global growth and trade are likely to keep expansion in exports of goods and services low.

……Financing a large CAD may pose difficulties in face of slowing foreign investment flows. External debt is likely to rise as increased debt flows bridge financing gap. As a result, external vulnerability indicators may deteriorate and would make economy susceptible to external shocks unless trade balance is compressed and FDI flows improve….".

4.17 To a specific query as to what drastic steps in the short-term had been taken by the RBI, the Governor, RBI during oral evidence replied as follows:-

"Sir, I really cannot comment on it because we did in the April policy statements reduce the policy rate by 50 basis points on the understanding that there would be some action from the Government to go along with that, and together there will be synergy between monetary policy and fiscal policy. It did not happen for a number of reasons. So, our own view, apart from the monetary policy stance being informed by the growth inflation dynamics, is that we also need to make sure that whatever we do will not deliver on its own. It has to be combined with Government action".

Financing CAD

4.18 While replying to a query as to how the Current account deficit has been financed, the Ministry of Finance (Department of Economic Affairs) submitted a written reply as under:-

"CAD is financed through capital flows of the both equity and debt varieties. Equity flows comprise foreign direct investment and portfolio investment and debt flows comprise external commercial borrowings, banking capital, external assistance and short-term credit etc. In a system of managed float of the exchange rate, if capital flows are in excess of the quantum of CAD, there will be accretion to foreign exchange reserves when the RBI intervenes in the forex market buying up foreign currency and vice versa. The sources of financing the CAD in the recent years indicate that the short-term trade credit financed CAD in the range of about one-tenth to one-fourth of CAD implying the dominance of other sources in financing CAD.

(US$ million)

Items	2010-11 (PR)	April-December	
		2010-11 (PR)	2011-12 (P)
A. Current Account Deficit (=B)	45,945	39,577	53,629
B. Sources (1+8)			
1. Foreign Direct Investment	9360	8,233	16,226
2. Portfolio Investment	30,293	30,095	3,244
3. External Assistance	4,941	4,190	2,091
4. Commercial Borrowings	12,506	9,551	9,984
5. Short-term Trade credit	10,990	8,283	5,809
6. Banking capital	4,962	5,740	13,857
7. Others	-14,055	-15,495	-4,675
8. Accretion (-)/Drawdown of Reserves (+)	-13,050	-11,019	7,093
Memo*: Short-term credit as % to CAD*	*23.9*	*20.9*	*10.8*

4.19 In this context, the Governor, RBI stated:-

"……CAD last year was 4.2 per cent, and that was not fully financed. We had to dip into our reserves, but it was largely financed. It was financed by both equity flows, debt flows, long-term flows, and short-term flows, but higher proportion of short-term flows, a higher proportion of debt flows, and a higher proportion of volatile flows.

……financing the current account deficit from domestic savings crowds out private investment, thus lowering growth prospects. This, in turn, deters capital inflows making it more difficult to finance the current account deficit. So, failure to narrow the twin deficits with appropriate policy actions threatens both macroeconomic stability and growth sustainability.

…… the RBI's position has been that as regards the external situation, the remedy lies in reducing the CAD, which cannot be done in the short-term. We have to reduce the CAD in the medium-term. In the short-term, we have to find stable sources of financing for it. Our response to the balance of payment concerns over the last 4-5-6 months have been to find increasingly riskier ways of financing the CAD. So, in order to solve a short-term problem, the concern is whether we are eroding the long-term sustainability, and I think that it is a very important consideration in managing the external situation".

c) Exchange Rate of Rupee

4.20 On the movement of exchange rate of Rupee, the Ministry of Finance (Department of Economic Affairs) stated as under:-

"The movement of exchange rate in the year 2011-12 indicated that the average monthly exchange rate of Rupee against the US dollar depreciated by 10.6 per cent from Rs. 44.97 per US dollar in March 2011 to Rs. 50.32 per US dollar in March 2012. Similarly, on point–to-point basis, the average exchange rate of rupee (average of buying and selling rate of FEDAI) depreciated by 12.7 per cent from Rs. 44.65 per US dollar on 31 March 2011 to Rs. 51.16 per US dollar on March 30, 2012.

In the fiscal 2012-13, monthly average exchange rate of Rupee has shown depreciating trend. It has depreciated by 2.9 per cent in April 2012, 4.9 per cent in May and 2.8 per cent in June 2012 over the previous month. In the month of June 2012, rupee touched its all time low of Rs.57.22 per US dollar (RBI's reference rate) on June 27, 2012 indicating 10.6 per cent depreciation over Rs.51.16 per US dollar on March 30, 2012.

……… However, in the month of July 2012, rupee has shown appreciating trend and it stood at Rs.55.42 against the US dollar on July 06, 2012, appreciating 3.2 per cent vis-à-vis the all time low of Rs. 57.22 per US dollar recorded on June 27, 2012. The gain for the Rupee was aided by progress made by EU in resolving the euro zone crisis, and by signs of improvements in market sentiments in domestic market.

Likely reasons for Rupee depreciation:-

- "The sharp decline in Rupee among others indicates supply-demand imbalance in the domestic foreign exchange market as there has been slowdown in FII inflows.
- The depreciation could also be partly explained by strengthening of US$ in the international market due to the *safe haven* status of US Treasuries and the decline of euro due to euro zone crisis along with appreciation of US dollar against euro in the international market.

- Global developments centered on the stubborn sovereign debt problem in the peripheral Euro zone countries which threaten the existence of Euro itself. The looming fear that countries like Greece, Italy, Portugal, Spain, etc. may default on their debt and the consequent impact on the European banks through direct exposure and banks elsewhere in the world including US has unleashed a fresh bout of risk aversion and flight to safety.
- Apart from the global factors, there are several domestic factors which have added to the weakening trend of the Rupee which include increasing current account deficit, high inflation and declining capital inflows because of weak growth prospects".

4.21 The details of movement of exchange rate of other emerging market economies as furnished by the Ministry, is given below:-

Movement in Exchange Rates of Select EMEs against US Dollar - Appreciation (+)/Depreciation (-) in percent							
Sl. No	Currency	End-March 2008@	End-March 2009@	End-March 2010@	End-March 2011	End-March 2012	June 6, 2012 over end-March 2012
	1	2	3	4	5	6	7
	Current Account Deficit Countries						
1.	Polish Zloty	23.4	-36.5	18.3	0.5	-8.6	-10.5
2.	Brazilian Real	20.5	-23.8	24.6	9.7	-10.8	-9.6
3	Mexican Peso	3.6	-24.8	14.0	4.3	-7.0	-9.5
4.	Czech Koruna	23.7	-22.5	8.9	7.8	-6.7	-9.1
5.	South African Rand	-10.2	-14.7	29.4	8.0	-11.5	-8.9
6.	Indian Rupee	9.1	-21.6	12.9	1.1	-12.7	-8.2
7.	Turkish Lira	6.1	-21.7	10.1	-4.8	-10.5	-3.1
	Current Account Surplus Countries						
1.	Russian Ruble	10.7	-30.7	14.9	3.4	-2.8	-9.6
2.	South Korea Won	-5.2	-28.0	21.7	2.2	-2.7	-3.5
3.	Malaysian Ringgit	8.4	-12.6	11.4	8.2	-1.4	-3.4
4.	Argentine Peso	-2.0	-14.8	-4.2	-4.3	-7.5	-2.2
5.	Thai Baht	11.3	-11.4	9.8	6.7	-1.8	-2.1
6.	Indonesian Rupiah	-1.1	-20.4	27.0	4.7	-5.1	-1.9
@: year-on-year variation.							

4.22 While talking about the slump in the value of Rupee, the Chief Economic Advisor, Government of India deposed before the Committee as under:

> "…….loss of value of the Brazilian currency, South African Rand completely on par with us over the last eighteen months or so, all losing value, even the South Korean Won, Mexican Peso in recent times all going together. So, this I do believe is a purely global situation".

4.23 In this regard, the RBI in a background note furnished to the Committee informed, *inter-alia,* as under:-

> "……In Q4 of 2011-12, the Indian rupee reversed its falling streak exhibited during most of the year and recorded some gains. Owing to the interplay of a mix of domestic and global factors, the rupee started weakening from April 2012. Subsequently however, the rupee gained due to improved FII flows coupled with the lower trade deficit partly aided by policy initiatives, and traded in a relatively narrow range.
>
> The depreciation of the exchange rate is not specific to India; most emerging and developing economies' currencies have also depreciated. However, the depreciation of Indian rupee is large reflecting growing current account deficit unlike other major Asian economies who have current account surpluses ….".

4.24 The Governor, RBI further added as follows:-

> "…..During 2012-13 so far, during the current fiscal year, the 6-,30-and 36-currency Real Effective Exchange Rate (REER) had depreciated by about seven to ten per cent reflecting the nominal depreciation of the rupee against the US dollar by around nine per cent. Actually, the nominal depreciation last year 2011-12 was about 13 per cent; this year, so far, has been about seven per cent. So, between, let us say, April 2011 and until today, the nominal depreciation has been about 20 per cent.
>
> The exchange rate depreciation in the first quarter of the current year was not specific to India. Most emerging and developing economic currencies also depreciated. However, even among emerging and developing economies with large current account deficits, the depreciation of the Indian rupee was relatively large reflecting moderation in capital inflows".

d) Investment Climate

4.25 Investment and capacity additions are critical for sustained industrial growth. National accounts data clearly indicate a moderation in the growth of Gross Capital Formation (GCF) in industry. The rate of growth of GCF

in four broad sectors of industry comprising mining, manufacturing, electricity, and construction averaged 10.9 per cent during 2004-11… In 2008-09, GCF had negative growth, but witnessed a sharp V-shaped recovery in 2009-10 before moderating to 7.0 per cent in 2010- 11. The manufacturing GCF growth rate declined to 7.1 per cent in 2010-11 from 42 per cent in 2009-10. The share of GCF in industry as per cent to the overall GCF, after peaking to a level of 54.9 per cent in 2007-08, moderated to 48.3 per cent in 2010-11.

4.26 In a background note furnished to the Committee, the RBI, inter-alia, stated as follows:-

> "The slow recovery in Q4 of 2011-12 reversed for most part of Q1 of 2012-13, on the backdrop of deceleration in industrial growth, weak revenue outlook for major Indian IT companies and concerns over the implementation of retrospective tax and General Anti-Avoidance Rules (GAAR). The Euro area crisis, the downgrade of India's long term rating outlook to negative from stable and the rupee slide also affected the market sentiment.
>
> The low risk appetite of investors coupled with a weak secondary market and negative returns on Initial Public Offerings (IPOs) led to low resource mobilisation in the primary segment in 2011-12. During 2012-13 so far (up to end-June 2012), the primary market continued to remain muted, with only Rs.5 billion mobilised through six public issues (four IPO and two rights issues)..
>
> Revival of investor confidence would, therefore, need to be supported by addressing concerns over policy stasis, while putting in place complimentary actions that address macroeconomic weaknesses".

4.27 In this regard, one of the representatives of the Ministry submitted as below:

> "….we do begin to cut interest rates so that the private sector invests a bit more. ……….some lowering of interest rates can uplift the mood".

4.28 On being asked about the prevailing investment climate in the country and the roadblock in creating a conducive atmosphere for investment, the Ministry of Finance (Department of Economic Affairs) in a post-evidence reply stated as under:-

> "One of the reasons, India achieved high growth of over 9 per-cent in the years 2005-6 to 2007-08 was that India's investment rate, particularly the private investment rate (mainly by the corporate sector) was also high. Investment by corporate sector averaged 15 percent of GDP in those three years as compared to an average of 12 percent in the subsequent three years. The overall investment rate also peaked in 2007-08. The factors that are responsible for reduced levels of investment include increased macroeconomic uncertainty arising from weaker global economic outlook, higher inflation and consequent monetary tightening. These factors, some which were exogenous, together with procedural and regulatory issues relating to delays in environmental clearances and land acquisition, affected investment sentiments and thus moderating investment level in the economy".

V. Policy Stance

5.1 Given the current state of certain factors in the growth of economy such as domestic savings, investment, domestic demands, inflation, fiscal deficit, current account deficit and depreciation of Rupee, the Ministry of Finance (Department of Economic Affairs) have been asked to comment on the future prospects of the Indian economy. In a response, the Ministry in a written reply stated the following:-

> "The Indian economy had been generally on the upswing between 2003-04 and 2007-08 and growth rate for these five years was around 8.7 per cent per annum. However, international factors viz. the global financial crisis triggered by the sub-prime crisis in the US, the collapse of Lehman Brothers played a significant role in global slowdown. This, along with low growth in agriculture sector as well as subdued activity in the industrial sector along with a reduction in investment activity resulted in a slowdown in the Indian economy in 2008-09. The Government responded to this slowdown by providing fiscal stimulus by reducing taxes and raising public expenditure. This raised the aggregate demand in the economy and was one of the factors that was responsible for the revival in growth rate of GDP in the next two years, viz. 2009-10 and 2010-11. However, the stimulus in the economy had an impact on the fiscal deficit which increased from 2.5 per cent of GDP in 2007-08 to 6.0 per cent of GDP in 2009-10. The higher level of demand, along with slower growth rate in agriculture sector and less than adequate supply response, resulted in higher headline inflation since January 2010. In order to rein in inflation, the RBI raised the repo rate as well as Cash Reserve Ratio (CRR). This raised the cost of borrowing in the economy and resulted in slowdown in the aggregate demand, including investment. This along with global

factors like Euro-zone crisis, low growth rate in many industrialized economies, hardening of international prices of crude oil contributed to the slowing down of the growth rate in the Indian economy".

5.2 The Ministry further stated:-

"The simultaneous occurrence of high global commodity prices with a global growth slowdown has impacted the Indian economy in 2011-12. A significant part of the widening of the current account deficit as well as fiscal deficit owe to the elevated levels of global crude prices and the less than full pass through of the same to domestic price that pushed up the subsidy outgo. With the continued uncertainty in the global economy and flight to safety, capital flows have also been impacted reflecting in the depreciation of the rupee. The recent softening of global commodity prices in tandem with lower non food manufacturing inflation offers scope for enhanced investment and thus brightens medium term prospects".

5.3 On being asked about the plans and the programmes of the Government to take the economy back on the growth path, the Ministry of Finance, in a written reply submitted as under:

"Budget 2012-13 aims at fiscal consolidation by reducing the fiscal deficit from 5.9 per cent of GDP in 2011-12 (RE) to 5.1 per cent of GDP, particularly through an endeavor to limiting the expenditure on Central subsidies to 2 per cent of GDP in 2012-13. This will be done by raising taxes and reducing wasteful expenditure and better targeting of subsidies. Reducing the fiscal deficit will leave greater amount of funds for private sector and help in reducing the interest rates that could lead to higher investment rate.

Steps proposed in the Budget to promote higher growth in agriculture include raising fund allocation, raising credit for agriculture to Rs. 575,000 crore in 2011-12, higher allocation for irrigation projects, etc. The budget aims at encouraging investment in infrastructure by raising limits for foreign institutional investor (FII) in the long-term, raising limits for external commercial borrowings, simplifying the process of issuing Initial Public Offers (IPOs), larger amount of tax-free bonds for financing infrastructure, etc. The Budget 2012-13 focuses on creating conditions for rapid revival of high growth in private investment and addressing supply bottlenecks in agriculture, energy and transport sectors, particularly in coal, power, national highways, railways and civil aviation. The harmonized master list of infrastructure will help in removing ambiguity in the policy and regulatory domain and encourage investment in the infrastructure sector. Scope of Viability Gap Funding (VGF) scheme for Support to PPP in infrastructure has also been extended to attract private investment. Infrastructure financing will also get a boost with an increase in the ceiling

of tax-free bonds for Rs. 60,000 crore. To address the immediate financing concerns of the civil aviation sector, external commercial borrowings (ECB) for working capital requirements of the airline industry for a period of one year has been proposed……In order to enhance availability of equity to MSME sector, it is proposed to set up India Opportunities Venture Fund with SIDBI with Rs 5000 crore".

5.4 The RBI, in its background note informed the Committee about the monetary and liquidity conditions as follows:-

"Monetary Policy Stance

The monetary policy stance would be (i) to contain inflation and anchor inflation expectations; (ii) to support a sustainable growth path over the medium term; and (iii) to continue to provide liquidity to facilitate credit availability to productive sectors.

Policy Guidance

The primary focus of monetary policy remains inflation control. Low and stable inflation is an essential pre-condition for securing sustainable growth over the medium term. While monetary actions over the past two years may have contributed to the growth slowdown – which is an unavoidable consequence – several other factors have also played a significant role. In the current circumstances, lowering policy rates will only aggravate inflationary impulses without necessarily stimulating growth. As the multiple constraints to growth are addressed, the Reserve Bank will suitably adjust its monetary policy stance.

Meanwhile, managing liquidity within the comfort zone remains an objective. The Reserve Bank will respond to liquidity pressures, including by way of Open Market Operations (OMOs).

In the current uncertain and turbulent global environment, the risk of external shocks is high. The Reserve Bank stands ready to respond to any such shocks swiftly, using all available instruments.

Expected Outcomes

The policy actions, and the guidance were expected to anchor inflation expectations based on the commitment of monetary policy to control inflation; and ensure that liquidity will be maintained to facilitate smooth flow of credit to the productive sectors of the economy and thereby support growth".

5.5 The RBI, further submitted through the background note as under:

"Liquidity which remained tight since November 2011, significantly eased in Q1 of 2012-13. The liquidity deficit returned to the Reserve Bank's comfort level of one per cent of Net Demand and Time Liabilities (NDTL) in July 2012.

The easing of liquidity stress in the system was brought about by the Reserve Bank actively managing liquidity through the Liquidity Adjustment Facility (LAF) and Open Market Operations (OMO). The Reserve Bank injected liquidity through outright OMO purchases of `0.8 trillion in the financial year so far. Also, there was some narrowing of the wedge between the pace of growth of deposits and credits in Q1 of 2012-13.

In order to provide greater liquidity cushion to banks, the borrowing limit of Scheduled Commercial Banks (SCBs) under the Marginal Standing Facility (MSF) was raised from one per cent of their NDTL to two per cent since April 17, 2012. To further augment liquidity and encourage banks to increase credit flow to the export sector, the Reserve Bank increased the limit of Export Credit Refinance (ECR) facility from 15 per cent of outstanding export credit to 50 per cent with effect from the fortnight beginning June 30, 2012. This amounted to release of additional liquidity support of over Rs.300 billion, equivalent to about 50 basis points reduction in the CRR. The daily average amount of ECR availed increased from Rs.70 billion in June 2012 to Rs.177 billion in July 2012 (up to July 26) ……

Reflecting the significant primary liquidity injection measures, there has been a pick-up in growth rate of broad money (M3) in 2012-13 so far as against the steady deceleration observed in the fourth quarter of 2011-12. ………..The mobilisation of deposits during the first quarter of 2012-13 was higher than in comparable period of recent years. The year-on-year (y-o-y) deposit growth of SCBs at 14.7 per cent on July 13, 2012 is somewhat below the indicative projection of 16 per cent for 2012-13…….

The y-o-y growth rate in non-food credit increased to 17.4 per cent in mid-July 2012 from 16.8 per cent at end-March 2012. Inclusive of banks' investment in commercial paper and other instruments, non-food credit growth was even higher at 17.7 per cent. Hence, credit growth is in line with the indicative trajectory of 17 per cent for the year.

Analysis of the sectoral deployment of credit (based on data from select banks which cover 95 per cent of total non-food credit extended by all SCBs) for Q1 of 2012-13 reveals that industries, services and personal loans accounted for 36.1 per cent, 28.6 per cent and 28.6 per cent, respectively, of the incremental credit flow during the quarter…….

There has been a 41 per cent increase in the total flow of financial resources to the commercial sector during 2012-13 so far, compared to the corresponding period of previous year. Unlike the previous year, banks as well as non-banks had a near equal contribution to funding in the economy during the period. The marked increase in funding from non-bank domestic sources was on account of higher issuances of Commercial Papers (CPs), accommodation from all Indian financial institutions (AIFIs), net credit by housing finance companies and LIC's net investment. Foreign sources of funding, however, declined compared to the corresponding period of the previous year. This is consistent with the slowdown in capital flows during the year so far..

5.6 During oral evidence, the Governor, RBI explained the latest decisions on policy rates as given below:-

"Based on an assessment of the current macroeconomic situation, in its policy review on July 31, the Reserve Bank kept the policy repo-rate and the CRR unchanged. However, we decided to reduce the SLR of scheduled commercial banks from 24 per cent to 23 per cent of their NDTL with effect from August 11, 2012.

While growth in 2011-12 was 6.5 per cent, down from 8.4 per cent in the year before, the headline WPI inflation has remained sticky, above 7 per cent. On the other hand, overall economic activity remained subdued. The Reserve Bank's estimates suggest that though the current rate of growth is lower than the post-crisis trend rate of growth of 7.5 per cent, the output gap is relatively small. Under these conditions, demand pressures on inflation can remerge quite quickly exacerbating the existing supply pressures. Accordingly, we kept the repo-rate and CRR unchanged.

….We reduced the SLR in order to encourage flow of credit to productive sectors. SLR was 24 per cent of NDTL before and came down to 23 per cent ……It reduced the burden on banks to the extent of about 680 billion rupees. But that is not automatic, it is not like CRR change. SLR change will give the banks a cushion to invest less in the Government securities and divert that much of credit to the private sector…….

…..Actually, our bench mark is one per cent of the NDTL which is about Rs.68,000 crore, we assured the market that we will keep the drawal of banks from the repo-window below Rs.68,000 crore".

Coordination between Fiscal Policy and Monetary Policy

5.7 Following the recent global financial crisis, several nations have been revisiting their regulatory architecture. India has also been prompt to act on this front. In 2010-11 two new agencies were set up—the Financial Stability Development Council (FSDC) and the Financial Sector Legislative Reforms Commission (FSLRC). The FSDC is a non-statutory apex council for coordination among various regulatory bodies, since in our increasingly complex economy, issues arise that straddle multiple financial jurisdictions and so risk falling through the cracks or getting caught in the crossfire. The FSLRC is supposed to outline the architecture of financial regulation and legislation in the future.

5.8 In a background note submitted to the Committee, the Ministry of Finance (Department of Economic Affairs), *inter-alia,* informed about the monetary policy and its impact on growth as follows:-

> "Reining in inflation has remained the primary objective of monetary policy in recent years. The RBI hiked the repo rate 13 times between March 2010 and October 2011, cumulatively by 375 basis points (bps). With supply-side factors feeding into food inflation and an uncertain economic scenario in advanced countries, the task of monetary policy calibration remained particularly challenging.
>
> Besides calibrating the policy rates, significant changes in the operating procedure of monetary policy have also been effected………Tight monetary policy, in particular, successive increases in repo rate had an adverse impact on growth. However, the period from December 2011 to January 2012 marked a reversal of the cycle with the RBI in its Third Quarter Review of Monetary Policy keeping the repo and reverse repo rates unchanged at 8.5 per cent and 7.5 per cent respectively. The Cash Reserve Ratio (CRR), however, was reduced from 6.0 to 4.75 per cent (in two tranches) in order to ease the liquidity situation. With moderation in inflation from over 9 per cent during most part of 2010 and 2011 to around 7 per cent since December 2011, repo rates were reduced by 50 basis points, from 8.5 per cent to 8.0 per cent effective April 17, 2012".

5.9 Chief Economic Advisor during oral evidence submitted before the Committee as follows:-

> "…….interest rates do play a role in stalling private investment and in today's global climate where some industrialised countries are holding

their interest rates close to zero. Germany, two-year bond is zero. In that situation the high interest rates are probably impacting on growth more than would have happened in other situation. So, the inflation played a role…..".

5.10 Asked to comment on the Government's views on RBI's monetary policy and its impact on the growth of economy, the Governor, RBI during oral evidence explained as under:-

"The first criticism against RBI has been that in spite of raising interest rates 13 times, we have not been able to contain inflation. On the other hand, we have restrained growth; therefore, monetary policy has been ineffective……I do not agree with that argument. It is not true that inflation has not come down. Inflation has come down. It was above 10 per cent as measured by WPI, and has come down to just about 7 per cent now. Core inflation which was over 8 per cent has come below 5 per cent………Yes, growth has moderated……you cannot control inflation without sacrificing a bit of growth. But our effort has been to ensure that even as we sacrifice growth in the short term, our medium term growth is secure… the Government's statement before the Committee saying that the growth moderation has been because of RBI's monetary tightening implying that it is entirely because of RBI's monetary tightening. I do not agree with that. I agree that our monetary tightening has had an impact on growth and I have also said that that is unavoidable and inevitable. But there certainly are other factors at play, both external and domestic, which have been responsible for growth moderation. We all heard about the negative investment sentiment of both our domestic investors and foreign investors, the uncertainty about the number of policy issues, the governance issues around the country, infrastructure bottlenecks, skill shortages. So, it is not just the monetary policy that is responsible for growth moderation, a number of other factors are at play. As several Members have suggested and I take that message very clearly that monetary policy and fiscal policy have to act in coordination.

The second criticism against RBI has been that much of the inflation today is coming from supply side pressures – food prices, oil prices, commodity prices. Monetary policy is an inappropriate and indeed a wrong instrument for controlling such inflation. Again, that is an argument with which the RBI does not agree. There are a number of reasons why even if inflation is stemming from the supply side, monetary policy has to be the first line of defence most notably because of inflation expectations. If inflation is persistent for a long time as is happening in our country, no doubt it is arising because of persistent food prices. They drive up inflation expectations and that tends to translate into core inflation. Also, if you have high inflation, it erodes competitiveness; also if you have high

inflation, it erodes savings, investment and growth potential. So, there is a transmission from supply side pressures to core inflation and that is why we believe that monetary policy has a role to play".

5.11 While replying to a query on the linkages and trade-offs between policy rate changes and growth in the Indian context, the Ministry of Finance (Department of Economic Affairs) in a post-evidence reply stated:-

"Changes in the policy rate are affected to reduce/control inflation at times when inflation is high and also to aid growth in the context of a slowdown. High inflationary pressures were evident in 2011-12 and in response to it the RBI followed a tight monetary policy and raised the Repo rate by 375 basis points between March 2010 and October 2011. Such increases in rates have affected growth via a slowdown in the industry sector that faced higher costs of borrowings.

At present, the RBI is continuing to follow relatively tight monetary policy, although there has been some reduction in Repo rate and reduction in Cash Reserve Ratio (CRR) as well as in statutory liquidity ratio (SLR). Achievement of higher growth in 2012-13 would also depend on the RBI's monetary policy stance in the months to come".

PART - II

OBSERVATIONS / RECOMMENDATIONS

Global Economy

1. The Committee find that global economy has been passing through a rather difficult phase and the developments over the last year in major economies of the world have not been encouraging. It is even apprehended that the process of global economic recovery that began after the financial crisis of 2008 is beginning to stall and the sovereign debt crisis in the euro zone area may persist for a while. Though the rate of growth in the global economy was 5.3 per cent in 2010, it declined to 3.9 per cent in 2011 and the International Monetary Fund (IMF) has projected its further decline to 3.5 per cent in 2012. As far as advanced economies are concerned, their rate of growth had halved from 3.2 per cent in 2010 to 1.6 per cent in 2011 and is expected to decline to 1.4 per cent in 2012. The risk of another crisis still looms large over the U.S economy and the Euro-zone clouds have far from cleared. However, comparatively sustained growth is projected for emerging and developing economies with a slowdown from 6¼ percent in 2011 to 5¾ percent in 2012, though they are not immune to the negative spillovers of the developments across the developed world.

2. The Committee have been informed that the adverse repercussions of the global slowdown is being felt in the Indian economy as well. This is evident from the movement of our growth-trajectory over the last one year

along with the trend in other critical macroeconomic parameters. The Committee are aware that this is not our first brush with adverse global economic scenario. Our country faced an economic crisis in 1991 and again in 1997 as a result of Asian economic crisis. The great recession of 2008 that engulfed the entire world also tested our resilience. The Committee, in the succeeding paragraphs of this Report, analyze *inter-alia,* the impact of global economic crisis on key economic parameters of the domestic economy and the policy options before the Government and the Reserve Bank of India (RBI).

Current state of the Indian Economy

3. The Committee are extremely concerned over the current gloom and doom scenario in the domestic economy and find almost all macroeconomic indicators disturbing during the financial year 2011-12. After achieving a GDP growth of 8.4 per cent and manageable current and fiscal deficits in 2010-11, the fiscal year 2011-12 has seen a period of economic downturn with overall GDP growth declining to 6.5 per cent. In the fourth quarter of 2011-12, the growth slipped to 5.3 per cent, the lowest ever in the last 9 years. Inflation remained stubborn at uncomfortably high levels despite monetary tightening and a grim situation of high inflation and low growth ensued. Compression in aggregate demand, weakened industrial growth, poor agricultural output resulting mainly from erratic monsoon, moderation in services sector, twin deficits on the current account and fiscal sides, steep downslide in the value of rupee, etc. have

been symptomatic of the economic turbulence in the macroeconomic environment of the country. In addition to the domestic problems, the Government have also cited global factors as the major reason for the slump. However, the Committee are of the view that the need of the hour is to put the economy back on growth track through a well thought out revival policy which may include less layered yet more effective decision making, time-bound clearance of projects, more transparent tax regime and enhanced domestic investment. The Committee, therefore, urge upon the Government to take clear-cut measures in this direction and implement them speedily and without fail.

GDP growth

4. The Committee find that the GDP growth has decelerated over successive quarters from 9.2 per cent in Q4 of 2010-11 to 5.3 per cent in Q4 of 2011-12, bringing down the overall growth for the last fiscal to 6.5 per cent. This is in comparison to an average GDP growth of 8.2 per cent in the last decade and a high of 9.6 per cent in 2006-07. The Committee were given to understand that the slump in growth in 2011-12 is mainly on account of the slowdown in the industrial sector to 3.4 per cent in 2011-12 as against 7.2 per cent in 2010-11 and lower growth of 2.8 per cent in agriculture sector in 2011-12 on top of a high growth rate of 7 per cent achieved in 2010-11. Services sector also registered a lower growth of 8.9 per cent during this period as compared to a growth of 9.3 per cent

achieved in 2010-11. However, the Committee find from the submissions of the Ministry of Finance that the Government is highly optimistic about the strong fundamentals of the Indian economy and expect 7.6 per cent growth during the current year i.e. 2012-13 also considered 'doable' by the Chief Economic Advisor while tendering evidence before the Committee. However, the Committee have serious apprehensions about the probability of achieving even a much lower growth especially in the wake of recent developments like the fall in industrial output by 1.8 per cent in June 2012, FDI inflows declining nearly 50 per cent in the first quarter of 2012-13 coupled with exports contracting by 15 per cent in July 2012. Above all, there is a total stalemate in policy reforms. The Committee also observe that a Planning Commission committee has recently cautioned the Government about a possible slip in economic growth to below 6 per cent. The same is the sentiment expressed by many international agencies. The Committee, therefore, urge upon the Government to re-orient its efforts for better and more balanced reforms for achieving sustainable growth. In this context, the Committee would like to point out that in their earlier Reports on economic issues, they have consistently advocated and recommended for a more balanced and inclusive approach to economic reforms and liberalisation.

Inclusive development

5. In the context of economic growth and per capita income, the Committee are concerned to note the emerging ever widening gap between the rich and poor and the increasingly disproportionate distribution of assets in our country. It is being observed that the purchasing power is getting concentrated in the hands of a few, whereas the majority is struck below the expenditure curve. Rise in prices, growing unemployment and diminishing real wages have made the poor languish, even as the better-off became more affluent, garnering the benefits of the economic growth our country had witnessed over the last few years. Even the indicators of the 68th round of the National Sample Survey which covered the household consumer expenditure during 2011-12 confirm this regressive phenomenon. It is observed that the poorest 10 per cent in urban areas lives on Rs 23.40 per day while their rural counterparts make do with even less at Rs 16.78. In comparison with the survey held in 2009-10, the monthly expenditure of the poorest 10 per cent population in rural India has risen by only 11.5%, while that of the richest 10 per cent has gone up by 38 per cent in the two years. In urban India, while the monthly expenditure of the poorest 10 per cent has risen by 17.2 per cent, that of the richest 10 per cent is seen to have gone up by 30.5 per cent. In a country where almost 40 per cent of the people live below poverty line, achieving inclusive growth, which is necessary for sustainable development and more equitable distribution of prosperity and benefits of

economic growth is undoubtedly the need of the hour. The Committee, however, believe that there are no short cuts to meet this challenge. In order to reduce poverty and bring the poor millions to the mainstream of our economy, the government has to strengthen social infrastructure through focused investments and extend food security and employment guarantee to the poor. The Committee would urge upon the Government to focus their energies and prioritise their expenditure on goals of inclusive development, namely in the areas of healthcare, education and shelter.

Savings and Investment

6. The Committee understand that savings and investment are the two critical macroeconomic variables with microeconomic foundations for achieving sustainable economic growth. They, therefore, are deeply concerned about the marked decline in domestic savings, domestic investments and demand in our economy. As per the Report of the Prime Minister's Economic Advisory Council (PMEAC), the Gross Domestic Fixed Capital Formation(GDFCF) as a proportion of GDP has continued to decline from its highest level of 32.9 per cent in 2007-08 to 30.4 per cent in 2010-11 and is estimated to fall 29.5 per cent in 2011-12. It is further observed that the gross domestic savings as percentage to GDP has also moderated from a peak of 36.8 per cent in 2007-08 to 32.3 per cent in 2010-11 and is estimated to come down to 31.5 per cent in 2011-12. This was mainly on account of a sharp decline in public savings from 5 per cent of GDP in

2007-08 to 1.7 per cent in 2010-11. Corporate savings also declined from 9.4 per cent of GDP in 2007-08 to 7.9 per cent in 2010-11. The household savings, which had increased to the highest rate ever achieved, i.e 25.4 per cent in 2009-10, moderated to 22.8 per cent in 2010-11. According to PMEAC, the net financial savings of households have fallen to their lowest levels in 15 years from 11.6 per cent of GDP in 2007-08 to 10 per cent in 2010-11 and possibly below 9 per cent in 2011-12. RBI's latest Financial Stability Report states that the deposit growth rate at 14 per cent as on March 31, 2012 is the lowest recorded in last 10 years. The Committee also note that the savings-investment gap during 2011-12 remained at 2.8 per cent of GDP, the same level as in 2009-10. Since 2008-09, this gap has been at relatively elevated levels, i.e in excess of 2 per cent of GDP as compared to 0.4 to 1.3 per cent in 2004-05 to 2007-08. While inflation was one of the factors for moderation in household savings, the decline in investment has been attributed by the Government to a sharp increase in the policy rates that resulted in higher costs of borrowings. On demand side also there has been a deceleration. Private consumption, a key driver of growth too has nosedived. As the Committee strongly feel that our growth story is based on domestic savings, investment and domestic demand rather than on external demands and supports, they view the revival of domestic demand, domestic savings and investments as the biggest challenges before the Government. To achieve and sustain growth at high levels, the Government and RBI should take concerted efforts to

increase domestic savings and investments through calibrated adjustments in policies.

Agriculture Sector

7. The Committee observe that the share of agricultural sector in the GDP has declined considerably over the last 60 years, from 53.1 per cent in 1950-51 to 13.9 per cent (Advance Estimates) in 2011-12. The overall long-term growth rate of the sector during the above period has been 2.7 per cent. It was 2.3 per cent between 1950-51 and 1980-81 and 3.1 per cent during 1980-81 to 2011-12. Even though the Government has put in place various schemes and programmes to boost the sector, the average annual growth realized by agriculture and allied sectors during the first four years of the Eleventh Plan Period, i.e. 2007-08 to 2010-11, is 3.3 per cent against the targeted growth rate of 4 per cent. In 2010-11, however, the growth reached 7.0 per cent, the highest rate achieved during the last six years, but to drop again to 2.8 per cent in 2011-12. Though the growth in agriculture and allied sectors have always shown significant variations over time, especially due to vagaries of nature, the main concern is that this sector has quite often fallen short of the Plan targets. To achieve targeted growth in agriculture, productivity gains and technology diffusion across regions is mandatory. Since agriculture plays a very important role in the all round socio economic development of the country and a large section of the rural population is dependent on agriculture for their

livelihood, the Committee urge upon the Government to make larger public investment in the sector and infuse funds especially for post-harvest technologies, infrastructure support, massive programmes for extensive irrigations facilities and ensure enhanced yet cheap credit to the farmers so as to achieve the targeted 4 per cent average growth in agriculture.

Industry and Manufacturing

8. The Committee are disappointed to see the fall in industrial growth from 8.4 per cent in 2009-10 and 7.2 per cent in 2010-11 to 3.4 per cent in 2011-12, which has been the main reason for the fall in overall GDP growth in 2011-12. The fall in industrial growth was on account of poor performance of particularly the manufacturing sector. The overall growth in the manufacturing sector moderated to 2.5 per cent in 2011-12 compared to a growth of 7.6 per cent in 2010-11. In fact, the decline was sequential in every quarter of 2011-12 from 7.3 per cent in first quarter to (-) 0.3 per cent in the fourth quarter. The situation unfurling in the current fiscal is again quite depressing. From the data released by the Central Statistical Office(CSO) for June 2012, the Committee find that the industrial output in the first quarter (April-June) has contracted by 0.1 per cent, against 6.9 per cent growth in the corresponding period during last fiscal. For the month of June 2012, the Index of Industrial Production(IIP) declined by 1.8 per cent, against growth of 9.5 per cent a year ago. IIPs for the Mining, Manufacturing and Electricity sectors for the month of June 2012 stand at 124.3, 178.1 and 157.0 respectively, with the corresponding growth rates of

0.6 per cent, (-)3.2per cent and 8.8 per cent as compared to June 2011. The cumulative growth in the three sectors during April-June 2012-13 over the corresponding period of 2011-12 has been (-) 1.1 per cent, (-)0.7 per cent and 6.4 per cent respectively. As per the latest Flash Report released in May 2012 by the Ministry of Statistics and Programme Implementation, the total cost overrun and per cent of cost overrun in respect to 564 central sector projects in different sectors is 19.5 per cent (Rs.1,43,042.97 crore) with respect to original cost. According to the Government, the slowdown in industry is due to a combination of domestic and external factors like higher borrowing cost, infrastructure bottlenecks, decline in investment and fall in exports. In order to address the problems in the sector, the Committee desire the Government to chalk out an action plan to create a positive investment climate, address supply-side constraints, provide incentives for capacity addition, rationalize interest rates on credit, step up the performance of the energy and transport sectors, bring down time and cost overruns in major infrastructure projects and create job opportunities by imparting skills to citizens. The Committee also desire the Government to implement and monitor the said action plan in a time-bound manner.

Credit to productive sectors

9. The Committee further note that the RBI's recent Statutory Liquidity Ratio (SLR) reduction from 24 per cent to 23 per cent of Net Demand and

Time Liabilities(NDTL) with effect from August 11, 2012 is done to give banks a cushion to extend more credit to private sector than investing in Government securities. This reduction in SLR is expected to infuse around Rs.68,000 crore in to the market which may encourage flow of credit to productive sectors of the economy. Since banks have a tendency to play safe and are at present holding excess SLRs due to subdued business confidence and poor risk appetite, the Committee apprehend whether the availability of extra resources would translate into higher lending by banks to productive sectors. Hence, they recommend that the RBI should review their existing guidelines in this regard so that the additional resources available with banks are channeled into productive sectors of the economy.

10. Further, the Committee note that though the stability of banking sector deteriorated marginally since September 2011, the soundness indicators of banks remained robust. While divergence between credit and deposit growth widened, bank's reliance on borrowed funds heightened liquidity risks. Since the global and domestic economies are still under extreme stress, the banks are exposed to added risks. Hence, the Committee desire that the RBI should strengthen the mechanism to protect the financial health of the banking sector. While ensuring this, the banks should not lose sight of their social responsibilities and focus on the revival of industrial growth.

Services sector

11. The Committee are extremely disturbed to note that even the services sector which has been the vital force steadily driving the Indian economy for over a decade too has shown signs of moderation. In 2011-12 there has been a dip in the growth of services to 8.9 per cent from 9.3 per cent in 2010-11 and 10.5 per cent in 2009-10 though the advanced estimates expected it to realize a growth rate of 9.4 per cent in 2011-12. The Committee understand that the global slowdown has been the main reason for the dip as is evident from the steep fall in export growth in services from 38.7 per cent in 2010-11 to 7.1 per cent in 2011-11, though there was a total turn around from a negative growth of (-)9.5 per cent in 2009-10 to 38.7 per cent in 2010-11. However, the Committee observe that the resilience of our economy to shocks owe to the services sector even in the current turbulence with its largest share of about 57.7 per cent of GDP in 2010-11 (Quick Estimate) and consistent growth performance when compared to agriculture and industry sectors. They further note that historically the share of the services sector increased from 30.3 per cent in 1950-51 to 38 per cent in 1980-81 and grew rapidly thereafter in the 1980s and 1990s balancing the entire decline in share of agriculture and industry in GDP growth. In view of the heavy dependence on services sector for our growth and its huge potential in employment generation, the Committee

recommend that a study group be constituted to identify the maladies in the sector and action be taken on priority basis to cure them.

<u>Exports and Imports</u>

12. The Committee note that exports have recorded a growth of 23.6 per cent (US$ 309.8 billion) during 2011-12 as compared to 37.5 per cent (US$ 250.6 billion) in 2010-11. Our imports too have registered a growth of 31.1 per cent (US$ 499.5 billion) from 26.7 per cent (US$ 381.1 billion) during the same period. This was mainly on account of higher imports of Petroleum, Oil and Lubricants (POL) and gold and silver. With imports, exceeding exports in 2011-12, our trade deficit has widened to 10.3 per cent of GDP as against 7.7 per cent of GDP in 2010-11, showing a year on year increase of 45.5 per cent. The Committee find that the significant depreciation in the value of rupee, rise in crude oil prices in the international markets, enhanced import of gold and silver along with the import of coal, fertilizer and edible oils have contributed to our trade deficit. Though the recent development of faster deceleration of imports than exports in the first quarter of 2012-13 has been bit relieving, the latest information that our exports have registered the sharpest fall in the last three years in July by 14.8 per cent owing to falling demand from Europe and US has dimmed the hopes of a possible improvement in the current account deficit in the current year. With the global conditions worsening, especially in the euro-zone, the downside risks to export growth still loom large over our

economic prospects. Though considerable diversification in our export presence beyond European Union and US to Asian and ASEAN countries has been achieved, there is still a greater need for reaching out to newer markets across the world and diversifying the basket of items of our export. At the same time, the Government should provide more incentives to exporters, enhance competitiveness of Indian goods in the global market by reducing transaction costs and create conducive domestic policy environment. The Committee also urge upon the Government to come out with new guidelines to revamp Special Economic Zones (SEZ) and Export Oriented Unit (EOU) schemes to boost exports. In order to bring down the huge outgo on imports the Government should explore options like promoting austerity in oil consumption, maintaining a strategic storage pool of oil to offset the price fluctuations of crude in the international market, alternatives like electric and hybrid vehicles, etc. and discourage the import of gold and silver.

<u>FDIs and FIIs</u>

13. From the submissions of the Chief Economic Advisor, the Committee understand that the Foreign Direct Investment (FDI) gross inflows to our country in 2011-12 was an all time high at US$ 46.8 billion as against US$ 29.4 billion in 2010-11. Net FDI inflows of US$ 22.1 billion and NRIs deposits at US$ 11.9 billion were also higher in 2011-12 *vis–a-vis* US$ 9.4 billion and US$ 3.2 billion respectively in 2010-11. The Committee also

note that during 2011-12, Foreign Institutional Investments (FIIs) inflows were US$ 16.8 billion, as against US$ 29.4 billion in 2010-11. But the euphoria about the record FDI inflows in the previous fiscal has given way to doubts about future prospects when the data released by the Reserve Bank of India in its monthly bulletin of August 2012 reveals that the FDI inflows have declined by about 54 per cent in the first quarter of the current fiscal in comparison to the same period last year. FDI to India in April-June 2012-13 fell to US$ 5.639 million as compared to US$ 12.172 million in the Q1 of 2011-12. The Foreign Institutional Investors too are seen to have withdrawn from the Indian market significantly during the period. The Committee understand that FDIs supplement domestic investments by bringing in capital, technology transfer, better management skills etc., whereas the FII inflows are considered as hot money for maintaining the current account. Since inflow of additional resources in the form of FDIs is crucial in financing India's huge investment requirements, investment climate of our country has to be improved considerably to attract FDI in areas like infrastructure, high technology and export oriented sectors. The Committee, therefore, recommend that the FDI policy may be reviewed by the Government to make India an increasingly attractive and investor-friendly destination for foreign investors.

Inflation

14. The Committee note that inflation has become so sticky despite sharp slowdown in growth and has emerged as a major challenge for our monetary policy. Though there has been some moderation in the level of inflation over a period of time, it has not fallen to the expected levels. During the financial year 2011-12, the headline Wholesale Price Index (WPI) inflation averaged 8.9 per cent as compared to 9.6 per cent during 2010-11. The Inflation data for June 2012 shows that the WPI inflation has increased from 7.5 per cent in April to 7.6 per cent in May before moderating to 7.3 percent in June. The July figures show a dip in food inflation to 10.06 per cent and WPI to 6.87 per cent. However, the stickiness in inflationary levels, the Committee observe, is mainly due to primary high food inflation which averaged 10.8 per cent during the first quarter of 2012-13. Meanwhile, the Committee find that unlike WPI, Consumer Price Index (CPI) (new series) inflation remained in double digit throughout the first quarter of 2012-13, i.e at 10.3 per cent in April and 10.4 per cent in May before falling to 10 per cent in June 2012 despite the monetary tightening measures adopted by the Reserve Bank of India to contain inflation and inflationary expectations. The divergence between WPI and CPI inflation, the Committee understand is on account of differences in the composition and weights of commodities, especially of food items in the two indices and inclusion of services in CPI but not in WPI. In view of the fact that WPI, the widely viewed measure of inflation in

India does not capture the price movements in services which form a huge part of the economic activity and core inflation, traditionally taken as the primary indicator to decide the policy course excludes food and fuels from the consumption basket, the Committee feel that a true representative measure of inflation is yet to be evolved. The Committee through their earlier Reports had expressed their reservation about the representative nature of indices used for policy formulation and they therefore recommend that the Government should work on indices which capture the market situation and reflect inflation more accurately. The Government may explore the feasibility of creating a new guage of inflation like the Producer Price Index (PPI) as proposed by the Reserve Bank of India.

Growth *Vs* Inflation

15. The Committee note that there is a divergence in the views of the Government and the Reserve Bank of India on price stability and growth. According to the Central Bank, inflation cannot be controlled without sacrificing a bit of growth. When inflation is in double digits, tightening monetary policy with a view to constraining demand becomes inevitable and a healthy single digit growth with low and steady inflation becomes the preferred philosophy. Reserve bank is also of the opinion that there is a threshold level of inflation, below which may be there is a trade-off between growth and inflation, but above which there is definitely no trade-off between these two. However, the prescription by the Government, on the

contrary, is for high growth even at the cost of higher inflation. The Committee are of the view that medium to long-term prospects are more important than short-term benefits and without providing a stable inflation regime the country cannot expect investments or consumption to pick up their needed momentum to propel growth.

Fiscal Deficit

16. The fiscal deficit, which is estimated to be 5.9 per cent of GDP in 2011-12 as against a target of 4.6 per cent, is at an uncomfortable level and has become an issue of great concern. The Committee find that at the end of June 2012, fiscal deficit has touched 37.1 per cent of the budgeted amount as the Government struggled to curtail expenditure. According to the data released by the Controller General of Accounts, the shortfall between expenditure and revenue stood at Rs.1.9 trillion. For the current financial year, the aim is to bring down the fiscal deficit to 5.1 per cent or about Rs.5.13 lakh crore. The Committee in their report on Demands for Grants(2012-13) had warned the Government about a possible fiscal slippage in 2012-13 in the absence of a clear fiscal roadmap. However, the Committee have been informed that the Government is committed to continue the process of fiscal consolidation to bring down the fiscal deficit to 4.5 per cent of GDP in 2013-14 and to 3.9 per cent of GDP in 2014-15. They further find that to keep the overall expenditure under the estimated level, the Budget for 2012-13 has proposed to cap the expenditure on subsidies to under 2 per cent of GDP. To achieve fiscal consolidation

effectively without undermining social commitments the Government should, among other measures, mop up resources through disinvestment by formulating a coherent and effective disinvestment policy as desired by the Committee in their earlier Reports. The Committee further recommend that the Government should come out with a specific action plan delineating methods to enhance efficiency in expenditure management; achieve 10 per cent mandatory reduction in non-plan expenditure; rationalize and monitor capital and revenue expenditures including subsidies; review the method of calculating notional under recoveries of oil companies on the basis of import parity pricing mechanism for petroleum products than on actual refinery costs; enhance gross revenue collection by plugging loopholes in the tax system to reduce tax avoidance, recovery of tax arrears and phasing out of tax exemptions/incentives for Corporates; optimise available resources and above all improve the quality of public expenditure.

Current Account Deficit

17. The Committee are also gravely concerned about the unsustainable Current Account Deficit (CAD) that has become a serious threat to the macroeconomic stability. In 2011-12, the country has reported an all time high CAD both in absolute terms as well as proportion to GDP at US$ 78.2 billion (4.2 per cent of GDP) *vis-à-vis* US$ 45.9 billion forming 2.7 percent of GDP in 2010-11. In January- March 2012 it was even higher at 4.5 per cent

of GDP in stark contrast to just 1.3 per cent in the corresponding quarter of the previous year. The sustainable level of CAD in our country is historically believed to be below 2 per cent of GDP and a CAD exceeding 4.0 per cent of GDP has caused a net drawdown on reserves of US$ 12.8 billion in 2011-12. This rise in CAD, the Committee understand, is because of widening trade deficit on account of subdued external demand and relatively inelastic imports of Petroleum, Oil and Lubricants (POL) as well as gold and silver. The slower GDP growth in 2011-12 coupled with depreciation of rupee added to the CAD-GDP divide. In this context, the Committee strongly feel that concerted efforts should be made by the Government to bring down the import of POL, discourage unproductive imports like gold and silver and boost competitive domestic production. In order to bring down the drain on domestic economy on account of import of petroleum products, the Committee desire that the use of alternate fuels may be considered and the Ethanol blending programme for petrol which has remained in limbo for too long may be implemented forthwith. Ways and means to reduce the use of hydrocarbons may also be given thrust.

<u>Financing of CAD</u>

18. The Committee are also concerned about the financing of a large CAD in the wake of decreasing exports, increasing imports and slowing foreign investment flows. Though the softening of global crude oil prices

and moderation in gold imports in the recent months are positive developments that may give a breather to balance of payment situation, the Committee are actually concerned about a higher proportion of the CAD being financed by short- term debt flows as this trend may threaten long-term sustainability and cause further deterioration in the external vulnerability indicators. Further, financing the current account deficit from the domestic savings crowd out private investment and thus lower import prospects. The Committee, therefore, recommend that the Government should aim at bringing CAD down in letter and spirit and financing it with relatively stable inflows.

<u>Subsidy</u>

19. The Committee find from the submissions of the Reserve Bank of India that the fiscal deficit target for 2012-13 may be breached due to likely overshooting of subsidies and shortfall in receipts. The Central bank has also called for adjustment of subsidies in the interest of fiscal consolidation and to encourage efficient use of scarce resources. At the same time, the Governor, RBI has submitted that the estimates based on certain assumptions shows that the proposed elimination of fuel subsidy can trigger an inflation spike of about 2.6 per cent. The Government have, however, informed the Committee that the measures taken by them like introduction of Nutrient Based Subsidy (NBS) mechanism for certain fertilizers and deregulation of petrol pricing, etc. have helped to an extent in reducing the expenditure on major subsidies. In view of the above and

the socio-economic commitments towards common people, the Committee strongly desire that better targeting of subsidies is what is required as a significant share of the subsidized products are being enjoyed by affluent sections of the society.

Value of Rupee

20. The Committee note that from April 2011 to July 2012, the nominal depreciation of rupee is about 20 per cent in comparison to the US Dollar. The movement of exchange rate in 2011-12 indicated that the average monthly exchange rate of rupee against the US dollar depreciated by 10.6 per cent from Rs. 44.97 in March 2011 to Rs. 50.32 per US dollar in March 2012. The rupee touched its all time low of Rs.57.22 per US dollar (RBI's reference rate) on 27 June 2012 indicating 10.6 per cent depreciation over Rs.51.16 per US dollar on 30 March 2012. This depreciation in exchange rate was not specific to India and most currencies in the emerging and developing economies also have depreciated. The Committee, however, find that except Brazilian Real (BRL), no other currency from the emerging economies has deteriorated as rapidly as Indian Rupee. The Committee also learn that the sharp decline in the Indian Rupee indicates among others, supply-demand imbalance in the domestic foreign exchange market due to slowdown in capital inflows and strengthening of US dollar in the international market due to the *safe haven* status of US Treasuries. Though depreciation of a currency due to deterioration of a country's trade balance is a part of the slowdown, the

Committee feel that RBI should intervene when there is undue volatility in the market. For the currency to stabilize, the Current Account Deficit (CAD) has to narrow down and to bridge the gap of CAD, our policies should attract more long-term capital inflows and push investments through reforms.

Investment climate in the country

21. The Committee find that the investment climate in the country has suffered a serious set back and investors confidence hit mainly because of the concerns over the impact of retrospective tax laws and new General Anti-Avoidance Rules(GAAR). Further, as informed by the RBI, the Euro-zone crisis and the downgrade of India's long term rating outlook has also affected the market sentiment. The Committee also note that stubbornly-high inflation, infrastructure bottlenecks, fall in value of rupee, higher interest rates, skill shortages, etc. too have contributed to denting the faith of domestic as well as foreign investors in our economy. To bring back the country on growth track investment needs to be pepped up and for investment to pick up a conducive investment climate needs to be created. Hence, the Committee recommend speeding up of policy reforms and removing investment hurdles. The Committee in their earlier Report on the Direct Taxes Code Bill, 2010 had expressed their reservations on GAAR proposals in its original form and had recommended for suitable amendments and guidelines in view of the apprehensions expressed by

stakeholders. They also look forward to clarity and consistency in policies and regulations so that investors, especially foreign investors do not shy away from investing in the country. The Government may also speed up enactment of the pending financial reform bills, *viz*. The Pension Fund Regulatory and Development Authority Bill, 2011, The Insurance Laws (Amendment) Bill, 2008, The Banking Laws (Amendment) Bill, 2011, The Prevention of Money Laundering (Amendment) Bill, 2011, The Direct Taxes Code Bill, 2010 and The Companies Bill, 2011 on which the Committee had already given their reports.

Monetary and Liquidity Management

22. The Committee find that the primary objective of the monetary policy of the Reserve Bank of India in recent years has been inflation control. Keeping in view this objective, the RBI hiked the repo rate 13 times between March 2010 and October 2011, cumulatively by 375 basis points. Changes in policy rate are resorted to rein in inflation when inflation is high and aid growth in the context of a slowdown. Citing high inflationary pressures, the RBI has followed a tight monetary policy and left the interest rates unchanged in its first quarter review of monetary policy, 2012-13. But, the Central bank has cut the Statutory Liquidity Ratio (SLR) by one percentage point to 23 per cent to facilitate smooth flow of credit to productive sectors to support growth. However, the Government views the tight monetary policy as a major drag on growth *via* a slowdown in the

industry sector which faces higher costs of borrowings. On the other hand, the RBI, while admitting that the monetary tightening has had an impact on growth has stated that the fiscal part of the obligation is not being fulfilled by the government. The Committee, thus, note with concern that there is a visible lack of sync between the fiscal and monetary policies being followed by the Government and the RBI. Since, the Committee strongly feel that monetary policy alone cannot bring down inflation or spur growth in the absence of commensurate fiscal measures, they urge upon the Government to take urgent steps to supplement and complement monetary measures with effective fiscal measures so as to rein in inflation and trigger sustainable growth.

New Delhi;	**YASHWANT SINHA**
28 August, 2012	**Chairman,**
6 Bhadra, 1934 (Saka)	**Standing Committee on Finance.**

NOTE OF DISSENT

Gurudas Dasgupta, MP

I had requested the Chairman, Finance Standing Committee, to kindly take up for discussion the current economic situation, slowdown of the economy and sky-high food inflation to enable us to scrutinize what were the causes in the policy that had led to present crisis, also to identify the loopholes in the strategy of Government that might have been overwhelmingly responsible for the present economic situation that is causing deep human distress. I thank Mr. Yashwant Sinha, Chairman of the Committee for taking up the subject for discussion.

Unfortunately, the Draft Report as prepared instead of critically examining the fundamentals of the economic policy and suggest effective alternatives, obviously the Government has failed miserably over years to stimulate inclusive growth, rather did not succeed even to maintain the rate of GDP growth attained earlier, it is today all time low at 5.3 per cent. It could not hold the price line mainly of the essential commodities including food articles, the Report objectively approved the policy that has been pursued by the Government. It does not even refer to the futility of the policies, non-performance of the Government. In my humble view, the Committee did not discharge its responsibility by patting on the back of the Government.

The present crisis cannot be attributed solely to the international crisis, second in two years. The present policy of unguarded liberalization, reckless privatization, unusual dependence on foreign funds, over dependence on export market, failure to curb speculation in a situation of scarcity, its total inability to provide economic empowerment to a vast section of the majority of the people, galloping disparity of income, increasing unprecedented concentration of wealth in the hands of the few is the basic negative feature that has been overlooked by the Committee.

Para 4:

The Report speaks of “economic incentive regime for accelerating and sustaining growth.”

Para 12:

The report states, “The Committee, hence recommend that the FDI policy may be reviewed by the Government to ensure the above and make India an increasingly attractive and investor friendly destination for foreign investors.”

Para 19:

The report says, “Our policies should attract more long-term capital inflows and push investments through reforms.”

The observations clearly approve the Government of India’s policy of economic reforms, FDI friendly, spelling out the undeniable message that it is the foreign investment that will engineer the process of accelerated economic growth obviously taking care of the basic human problems. This proposition has not been found to be correct anywhere in the world. The Committee rejecting all the Indian realities, by implication seeks to strengthen the hands of the government to bulldoze its people unfriendly economic reform. The report will give a free hand to the government to allow FDI in the retail trade, further tax concession to the corporates in the Special Economic Zone, it will lead to more violation of labour laws, it will enable the Government to infuse FDI in the banking and insurance having proportionate voting rights. In the name of attracting foreign funds it will bestow more concessions undermining the national interest, making India the most attractive hunting ground for the international players looking for unlimited profits exploiting national resources and manpower.

This is not to deny the role of FDI in the national development. But by all means it is subsidiary. Primarily the growth of the economy depends on national resources augmenting progressive tax revenue, broadening the tax base, reducing the tax concession, holding up tax avoidance, by waging all out war to retrieve black money, curbing unaccounted income, effectively fighting corruption and reducing wasteful expenditure and relocating priorities in the process of budget making.

The report is stereotyped, does not search for alternative policy which the nation is looking for.

There is no word for stimulating the domestic market, enlarging the empowerment of the marginalised majority. The direction of the report is extremely flawed.

The report in the background of the agricultural crisis does not call for heavy public investment in agriculture, only asks for 'infusion of funds' without identifying the source of funds. While investment in agriculture has been dwindling down over years, both public and private, the Report does not look beyond then nose, makes a superfluous comment on the need of infusion of funds. It is unlikely to happen.

Nevertheless it is correct to say that private investment has a crucial role in a mixed economy like India. But in a situation of gloom and downturn, it is massive government investment targeted to augment the income of the common people, for creating job, ensuring stability of income of the disadvantaged, even incurring budget deficit can turn around the economy. Heavy government investment will stimulate the market, generate the income, improve aggregate demand as a result market shall look up creating the atmosphere for the inflow of profit oriented private investment, even draw foreign funds. Unfortunately, the alternative perception is ignored and discarded by the Report and in fact it strengthens the hands of the government to carry forward the present anti-people economic policies.

Even the report suggests disinvestment for raising revenue, when the market sentiment is so negative it is in fact recommending sale of family silver to meet the grocer's bill. The Committee unfortunately goes so far as to suggest 10 per cent reduction in the non-plan expenditure which essentially suggests to reduce subsidy obviously hurting the common people. This is quite in line with what the present government wants to do. In the name of quoting RBI, the report puts on record with concern the question of 'overshooting of subsidies'.

Para 20:

The Committee even refers to with concern the impact of 'retrospective tax laws' and 'general anti-tax avoidance rules'. It calls upon the Government to

modify/withdrawal these laws so that investors' interest is not hurt. It calls upon the government for the speedy enactment of the financial reform Bill including Pension Fund Regulatory and Development Authority Bill, the Companies Law Amendment Bill. The report undoubtedly shall be feather in the cap of Dr. Manmohan Singh's Government.

The report speaks of strengthening the health of the banks thereby seeking to permit the government for going for merger of the banks undermining the national interest. It also opens the door for private investment in banks diluting its public sector character.

Since the report is one sided, seeks to strengthen the hand of the government in pushing through all its corporate friendly reform programme at the cost of the interest of the people, since the report does not locate the fundamental anachronism in the economic policy that has led to a situation of slowdown and food inflation, almost taking the country to the threshold stagflation, since the report is in fact an apology for the inaction of the government and since the report does not find any fundamental flaw in the policy and refrains from outlining people friendly suggestions I have no other alternative put to put on record my dissent. It is unfortunate that the report is likely to serve as a readymade weapon in the hand of the government to defend its failed economic policy ruining the country.

Sd/-
(GURUDAS DASGUPTA)

NOTE OF DISSENT

P. Rajeeve, MP

I express my dissent to the proposed draft Report on Current economic situation and policy options based on following considerations:

1. The difficulty is that the analysis of the current economic situation seems to be based almost completely on submissions from officials, particularly from the Ministry of Finance and the Reserve Bank of India. Thus while it reflects some of the differences within government, it does not have the favour of an independent assessment of the current economic situation and the resulting challenges and policy options.

2. Unfortunately, this has influenced the policy stance adopted in the recommendations included in the draft report. That stance, while recognising that growth has slowed, the international environment is deteriorating and aggregate expenditure/absorption in the economy is falling, settles for supply side solutions to the growth problem. Almost imitating the errors that are aggravating the crisis in Europe, the government is worsening the slowdown by holding back on expenditures. This leads the report to contradictory positions on addressing inflation as we shall suggest below.

3. An implicit assumption on which the report is based seems to be that there are few options for substantially increasing resource mobilization at the centre and sharing the additional resources equitably, so as to provide the basis for enhancing expenditure at the margin. In addition, the position adopted seems to be that given the current level of the fiscal deficit there is no space for manoeuvre on the expenditure side unless substantial fiscal savings can be generated.

4. In the view of this member, through the closure of loopholes in the tax system that reduce tax avoidance, through better monitoring and scrutiny that prevents evasion, through the recovery of tax arrears, through the curtailment of the huge tax concessions (wrongly described as tax “expenditures” in budget documents) to the corporate sector and the well to do, and through appropriate additional resource mobilization with new direct taxes, substantial resources can be mobilised to enhanced expenditures.

5. Having, ignored this, the draft report uncritically accepts the view that, given lack of fiscal headroom, increased spending would depend on reducing expenditures. What is more the expenditures being emphasized are subsidies on a host of commodities stretching from food, through fertilizers to oil and oil products (including diesel). That is, while revenue generation based on lower concessions for and higher taxes on those with the capacity to pay are abjured, expenditure saving based on reduced concessions to the poor and fixed income earners are being advocated. This makes many of the recommendations of the report not just anti-growth but also regressive and anti-poor.

6. The Report even seems to go along with the view that a part of this reduction in expenditures should be used to reduce the fiscal deficit to rein in inflation that still runs high in the current stagflationary environment . So expenditure saving is required not just to push growth but combat inflation. This is an obvious contradiction. It is quite clear that the current inflation is largely the result of cost push factors. Given that, reducing subsidies would involve raising administered prices of food, fertilizers, oil and oil products, the cost push effects of such measures would be quite substantial. This would aggravate not curb inflation.

7. So, I strongly oppose the recommendation in Para 18 for reducing the subsidies on diesel and LPG which would leads to further inflation. I also oppose the recommendation for fast tracking disinvestment in Para 15 of the recommendations in the Report.

8. It because of the role of cost push factors that the RBI's effort to hike interest rates by a huge margin over many rounds has not really worked, while it has had some adverse effects on growth. In sum, what is required is an expansion in expenditure, part financed with taxation, and a direct effort to address inflationary trends.

9. Rather than go in that direction, the report seems to be using the current impasse as an excuse for furthering liberalization that is what underlies cost push inflation and the fiscal crunch. This it does in three ways: (i) Not having any answer to the slowdown, the report calls for an improvement in the investment

environment that includes more concessions for private investors (domestic and foreign), including fast track clearances and government support of the kind that underlie the spectrum and coal scams. (ii) It calls for disinvestment and privatization as means of "mobilizing" resources, and paves the way for the fire sale of cash rich and profitable enterprises, as happened in the case of VSNL. (iii) It makes a case for policies to appease and attract foreign capital using figures on FDI for a few months, whereas what is called for is an examination of trends in aggregate foreign capital (FDI and FII) inflow over a reasonably long period, especially because the definitional difference between FDI and FII is an arbitrary 10 per cent of equity ownership in the invested company. Many FII players want more that a 10 per cent stake for large capital gains and get treated as direct investors.

10. Finally, a shocking feature of the report is its failure to adequately highlight the deep agrarian crisis (leading to farmers' suicides) that has affected the country for many years now and is likely to be aggravated by the poor monsoon in many part of the country. It therefore has little to offer by way of policies to restore the viability of crop production and improve the livelihoods of farmers, tenants and agricultural workers.

11. In sum, the draft report turns out to be a poor analysis of the current economic scenario; offers policies that are wrong (and contradictory) to deal with stagnation; and reduces itself to a mere apology for liberalization, which is responsible for the crisis here and elsewhere.

Sd/-

(P. RAJEEVE)

MINUTES OF THE TWENTY FIRST SITTING OF THE STANDING COMMITTEE ON FINANCE (2011-12)

The Committee sat on Thursday, the 7th June, 2012 from 1130 hrs to 1700 hrs.

PRESENT

Shri Yashwant Sinha – Chairman

MEMBERS

LOK SABHA

2. Shri Nishikant Dubey
3. Shri Bhartruhari Mahtab
4. Shri Prem Das Rai
5. Shri Sarvey Sathyanarayana
6. Shri Yashvir Singh
7. Shri R. Thamaraiselvan

RAJYA SABHA

8. Shri P. Rajeeve
9. Dr.K.V.P. Ramachandra Rao
10. Shri Vijay Jawaharlal Darda
11. Shri Ravi Shankar Prasad
12. Smt. Renuka Chowdhury
13. Shri Piyush Goyal

SECRETARIAT

1. Shri A.K. Singh – Joint Secretary
2. Shri R.K. Jain – Director
3. Shri Ramkumar Suryanarayanan – Deputy Secretary

Part I

(1130 hrs. to 1330 hrs.)

XX XX XX XX

XX XX XX XX

Part II

(1500 hrs. to 1700 hrs.)

WITNESSES

1. Shri R.S. Gujral, Finance Secretary
2. Shri R. Gopalan, Secretary (Economic Affairs)
3. Shri Sumit Bose, Secretary (Expenditure)
4. Shri D.K. Mittal, Secretary (Financial Services)
5. Shri Kaushik Basu, Chief Economic Adviser
6. Shri Bimal Julka, Addl. Secretary & DG
7. Shri Shaktikanta Das, Addl. Secretary (EA)
8. Shri Dipak Dasgupta, Principal Economic Adviser
9. Shri M.C. Singh, Sr. Economic Adviser
10. Shri Thomas Mathew, Joint Secretary (CM)
11. Shri Rajesh Khullar, Joint Secretary (I&I)
12. Shri Rajat Bhargava, Joint Secretary (Budget)

4. The Committee, thereafter, took oral evidence of the Ministry of Finance (Department of Economic Affairs) on the subject, 'The Current Economic Situation". The major issues discussed included factors responsible for slow down in the growth of Indian economy; resilience of the Indian economy to global economic developments; contingency plan for the Euro zone meltdown; decline in growth of exports; fall in domestic savings rate; widening current account deficit; persisting high inflation; depreciation of rupee; chalking out fiscal roadmap in concrete terms for the year 2012-13; measures taken for concrete fiscal results; and bringing back growth dynamics into the Indian economy, etc. The Chairman directed the representatives of the Ministry of Finance (Department of Economic Affairs) to furnish replies to the points raised by the Members during the discussion within a week's time.

A verbatim record of proceedings was kept.

The witnesses then withdrew.

The Committee then adjourned.

MINUTES OF THE TWENTY EIGHTH SITTING OF THE STANDING COMMITTEE ON FINANCE (2011-12)

The Committee sat on Friday, the 27th July, 2012 from 1100 hrs to 1620 hrs.

PRESENT

Shri Yashwant Sinha – Chairman

MEMBERS

LOK SABHA

2. Shri Shivkumar Udasi
3. Shri Jayant Chaudhary
4. Shri Bhakta Charan Das
5. Shri Gurudas Dasgupta
6. Shri Nishikant Dubey
7. Shri Bhartruhari Mahtab
8. Dr. Kavuru Sambasiva Rao.
9. Shri Rayapati S. Rao
10. Shri Sarvey Sathyanarayana
11. Shri Yashvir Singh
12. Shri R. Thamaraiselvan

RAJYA SABHA

13. Shri Naresh Agrawal
14. Smt. Renuka Chowdhury
15. Shri Piyush Goyal
16. Dr. Mahendra Prasad
17. Shri Ravi Shankar Prasad
18. Dr. K.V.P. Ramachandra Rao
19. Shri Y.P. Trivedi

SECRETARIAT

1. Shri A.K. Singh - Joint Secretary
2. Shri R.K. Jain - Director
3. Shri Ramkumar Suryanarayanan - Deputy Secretary
4. Smt. Reena Gopalakrishnan - Deputy Secretary
5. Shri Kulmohan Singh Arora - Under Secretary

Part I

(1100 hrs. to 1230 hrs.)

WITNESSES

xx	xx	xx	xx
xx	xx	xx	xx

The witnesses then withdrew.

Part II

(1230 hrs. to 1620 hrs.)

WITNESSES

1. Shri R.S. Gujral, Finance Secretary
2. Shri R. Gopalan, Secretary (Economic Affairs)
3. Shri D.K. Mittal, Secretary (Financial Services)
4. Shri Kaushik Basu, Chief Economic Adviser
5. Shri Shaktikanta Das, Addl. Secretary (EA)
6. Shri Rajat Bhargava, Joint Secretary (Budget)
7. Dr. Dipak Dasgupta, Principal Economic Adviser
8. Shri Rajesh Khullar, Joint Secretary (I&I)
9. Shri M.C. Singhi, Sr. Economic Adviser
10. Dr. H.A.C. Prasad, Sr. Economic Adviser

5. The Committee thereafter took oral evidence of the Ministry of Finance (Department of Economic Affairs) on the subject 'The Current Economic Situation and Policy Options'. The major issues that came up during the discussion included the domestic and global factors that led to the slowdown in the economy, the crisis of double digit inflation; fall in domestic savings; monetary policy decisions; the prevailing investment climate and the loss of confidence of investors; the status of FDIs and FIIs; widening current account deficit; fluctuations in the value of currency; measures taken for concrete fiscal results; and bringing back growth dynamics into the Indian economy, etc. The Chairman directed the representatives of the Ministry of Finance (Department of Economic Affairs) to furnish replies to the points raised by the Members during the discussion within a week's time.

A verbatim record of the proceedings was kept.

The witnesses then withdrew.

The Committee then adjourned.

MINUTES OF THE TWENTY NINTH SITTING OF THE STANDING COMMITTEE ON FINANCE (2011-12)

The Committee sat on Monday, the 6th August, 2012 from 1100 hrs to 1515 hrs.

PRESENT

Shri Yashwant Sinha – Chairman

MEMBERS

LOK SABHA

2. Shri Shivkumar Udasi
3. Shri Bhakta Charan Das
4. Shri Gurudas Dasgupta
5. Shri Nishikant Dubey
6. Shri Bhartruhari Mahtab
7. Shri Anjan Kumar Yadav M.
8. Shri Prem Das Rai
9. Dr. Kavuru Sambasiva Rao
10. Shri Magunta Sreenivasulu Reddy
11. Shri Sarvey Sathyanarayana

RAJYA SABHA

12. Shri Naresh Agrawal
13. Smt. Renuka Chowdhury
14. Shri Vijay Jawaharlal Darda
15. Shri Piyush Goyal
16. Shri Satish Chandra Misra
17. Dr. Mahendra Prasad
18. Shri Ravi Shankar Prasad
19. Shri P. Rajeeve
20. Dr. K.V.P. Ramachandra Rao

SECRETARIAT

1. Shri A.K. Singh - Joint Secretary
2. Shri R.K. Jain - Director
3. Smt. Reena Gopalakrishnan - Deputy Secretary

WITNESSES

RESERVE BANK OF INDIA (RBI)

1. Dr. D. Subbarao, Governor
2. Dr. Subir Gokarn, Deputy Governor
3. Shri Deepak Mohanty, Executive Director
4. Dr. Michael D. Patra, Adviser-in-Charge, Monetary Policy Department
5. Dr. (Smt.) Praggya Das, Director, Monetary Policy Department

2. The Committee took oral evidence of the representatives of Reserve Bank of India (RBI) on the subject 'The Current Economic Situation and Policy Options'. The major issues that came up during the discussion included the monetary policy stance; domestic economic developments; impact of global economic factors on domestic economy; savings and investment ratio to GDP; performance of external sector; price situation, adjustment of subsidies and its impact on inflation; threshold level of inflation; Growth-Inflation link; fiscal consolidation; movement of exchange rate of rupee; coordination between fiscal and monetary policies, etc. The Chairman directed the representatives of the Reserve Bank of India (RBI) to furnish replies to the points raised by the Members during the discussion within a week's time.

A verbatim record of the proceedings was kept.

The witnesses then withdrew.

The Committee then adjourned.

MINUTES OF THE THIRTIETH SITTING OF THE STANDING COMMITTEE ON FINANCE (2011-12)

The Committee sat on Tuesday, the 28th August, 2012 from 1515 hrs to 1600 hrs.

PRESENT

Shri Yashwant Sinha – Chairman

MEMBERS

LOK SABHA

2. Shri Shivkumar Udasi
3. Shri Harishchandra Deoram Chavan
4. Shri Bhakta Charan Das
5. Shri Gurudas Dasgupta
6. Shri Bhartruhari Mahtab
7. Shri Prem Das Rai
8. Dr. Kavuru Sambasiva Rao
9. Shri Rayapati S. Rao
10. Shri Magunta Sreenivasulu Reddy
11. Shri R. Thamaraiselvan

RAJYA SABHA

12. Smt. Renuka Chowdhury
13. Shri Vijay Jawaharlal Darda
14. Shri Piyush Goyal
15. Dr. Mahendra Prasad

SECRETARIAT

1. Shri A.K. Singh – Joint Secretary
2. Shri R.K. Jain – Director
3. Shri Ramkumar Suryanarayanan – Deputy Secretary
4. Smt. Reena Gopalakrishnan – Deputy Secretary

2. The Committee took up the draft Report on the 'Current Economic Situation and Policy Options' for consideration and adoption.

3. The Committee adopted the above draft report with some minor modifications as suggested by Members. The Committee authorised the Chairman to finalise the Report in the light of the modifications suggested and present the same to Parliament.