THE WORLD - INDIA & THE ROAD AHEAD

Q S Consultants India Pvt. Ltd.

INTRODUCTION

Established in February 2008, Q S Consultants was conceptualized as a consultation firm providing advisory services in the Travel & Tourism, Infrastructure and Sustainable Business Practices Areas, bringing dedicated expertise and an imaginative approach to meet the demands of an industry in the midst of rapid transition and offer well-defined and executable strategies to achieve business objectives.

Helping you make the

right choice

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Preface

The rise in complexity and globalization of financial services and trade linkages have traditionally contributed to overall economic growth by smoothing credit allocation and allowing greater risk diversification. However, they have also increased the potential for a rapid spread of disruption swiftly across markets and borders particularly as resultant risks were not fully recognized by regulators or institutions complicating risk assessment, management and policy responses.

The current global crisis has highlighted the relevance of economic spillovers, specifically that (a) the interconnectedness means difficulties in rolling over liabilities may spread to the system as a whole and (b) rollover risks associated with such liabilities are present equally across sectors. The tight links between global trade in durable, capital, and high-tech goods and the closely entwined investment spending that supports economic activity in both high-income and developing countries can be detected in the iterative cycle that now operates between the financial and real sectors of the global economy. As the current crisis broadens to include households, corporations and banks worldwide, shrinking economic activity continues to degrade asset values, threaten capital adequacy and discourage fresh lending. While substantial private sector adjustment and public finance stimuli have contributed to early stabilization, the key challenge is to break the downward spiral between the financial systems and the global economy. In this context, global trade linkages and impetus to global trade through effective macro-prudential policy decisions and international coordination would provide a more stable and resilient platform for sustained economic growth.

During the last two years, India has faced three major challenges originating in its external sector; (a) a surge in capital inflows hitting it's maximum in Q4 (2007-08); (b) an inflationary explosion in global commodity prices in mid 2008 and (c) the global financial meltdown and collapse of international trade in H2 (2008-09). The severe economic impact of these shocks highlights the importance of international linkages with the external sector. While the short term challenges have been addressed through a series of fiscal and monetary stimuli, the medium term implications need to be met by a considered and integrated response including a focus on expansion and revival of international trade to achieve the national objective of sustained high economic growth.

The report aims to elucidate the international trade linkages, both within a global and an Indian context, bringing to the fore the importance of international trade on the economic wellbeing of the global and Indian economies.

Understanding the Global Economy

The rapid and widespread impact of the recent global recession has firmly established the existence of strong economic linkages within economic regions and countries across the world today. Countries and economic regions are globally categorized into Advanced and Emerging & Developing economies.

It is interesting to note that:

- 33 advanced economies produce 55.3% of global GDP and export 65.1% of global goods and services while catering to only 15.3% of global population.
- 139 emerging and developing economies produce 44.7% of global GDP and export 34.9% of global goods and services while catering to 84.7% of global population.
- India is an emerging economy that produces 4.8% of global GDP (10.7% of E&D economies) and exports 1.4% of global goods and services (3.9% of E&D economies1) and caters to 18.1% of global population (21.4% of E&D economies[1]).

Table 1: Economic Regions & Countries in Aggregate GDP, Exports of Goods and Services and Population (2008)

Regions/Countries	Number of Economies	GDP		Export of Goods & Services		Population	
		Advanced Economies	World	Advanced Economies	World	Advanced Economies	World
Advanced Economies	**33**	**100.0**	**55.3**	**100.0**	**65.1**	**100.0**	**15.3**
United States		37.4	20.7	14.3	9.3	30.3	4.6
Euro Area	16	28.5	15.7	43.9	28.6	32.4	5.0
Germany		7.6	4.2	13.4	8.7	8.2	1.2
France		5.6	3.1	5.9	3.8	6.2	0.9
Italy		4.8	2.6	5.3	3.4	5.9	0.9
Spain		3.7	2.0	3.4	2.2	4.5	0.7
Japan		11.5	6.4	7.0	14.5	12.7	1.9
United Kingdom		5.8	3.2	6.0	3.9	6.1	0.9
Canada		3.4	1.9	4.1	2.7	3.3	0.5
Other advanced economies	13	13.3	7.4	24.6	16.0	15.3	2.3
Memorandum							
Major advanced economies	7	76.2		56.1	36.5	72.6	11.1
Newly industrialized Asian economies	4	6.7		13.1	8.5	8.3	1.3
		Emerging & Developing Economies	World	Emerging & Developing Economies	World	Emerging & Developing Economies	World
Emerging & Developing Economies	**139**	**100.0**	**44.7**	**100.0**	**34.9**	**100.0**	**84.7**
Africa	47	6.9	3.1	7.8	2.7	15.2	12.9
Sub-Sahara	44	5.5	2.4	5.7	2.0	13.8	11.7
Excluding Nigeria & South Africa	42	2.8	1.3	3.1	1.1	10.3	8.7
Central & Eastern Europe	11	7.8	3.5	10.3	3.6	2.9	2.5
Commonwealth of Independent States	13	10.3	4.6	11.5	4.0	5.0	4.3
Russia		7.4	3.3	7.6	2.7	2.6	2.2
Developing Asia	23	46.9	21.0	39.5	13.8	62.4	52.9
China		25.5	11.4	24.1	8.4	23.8	20.2
India		10.7	4.8	3.9	1.4	21.4	18.1
Excluding China & India	21	10.8	4.8	11.5	4.0	17.2	14.5
Middle East	13	8.7	3.9	16.2	5.6	4.4	3.7
Western Hemisphere	32	19.3	8.6	14.7	5.1	10.0	8.5
Brazil		6.4	2.9	3.3	1.2	3.4	2.9
Mexico		5.0	2.2	4.5	1.6	1.9	1.6

[1] Emerging and Developing Economies are as defined by global conventions

Recent Economic and Financial Developments...

- The recession in the global economy is inflicted by the recession and the resulting loss of business confidence.
- Real GDP declined 7.5% in advanced economies during Q4 (2008) and in emerging economies by 4%.
- World output is expected to decline by a little over 2% in 2009. Gradual recovery in later half of 2010 will see a growth by 1.5%.
- Output from advanced economies is expected to decline by 3.8% in 2009 with a straight line in 2010. Output from emerging and developing economies is expected to grow by 1.6% in 2009 and 4% in 2010.
- The U.S. economy has been impacted mainly by intensified financial strains and housing sector imbalance. Western Europe and advanced Asia have been severely hit by the deterioration in global trade, deepening financial crisis and housing corrections in some national markets. Trade and financial linkages have been the main transmission channels, particularly to East Asian countries (rely heavily on manufacturing exports) and the emerging European and Commonwealth of Independent States (CIS) economies (depend on strong capital inflows to fuel growth).

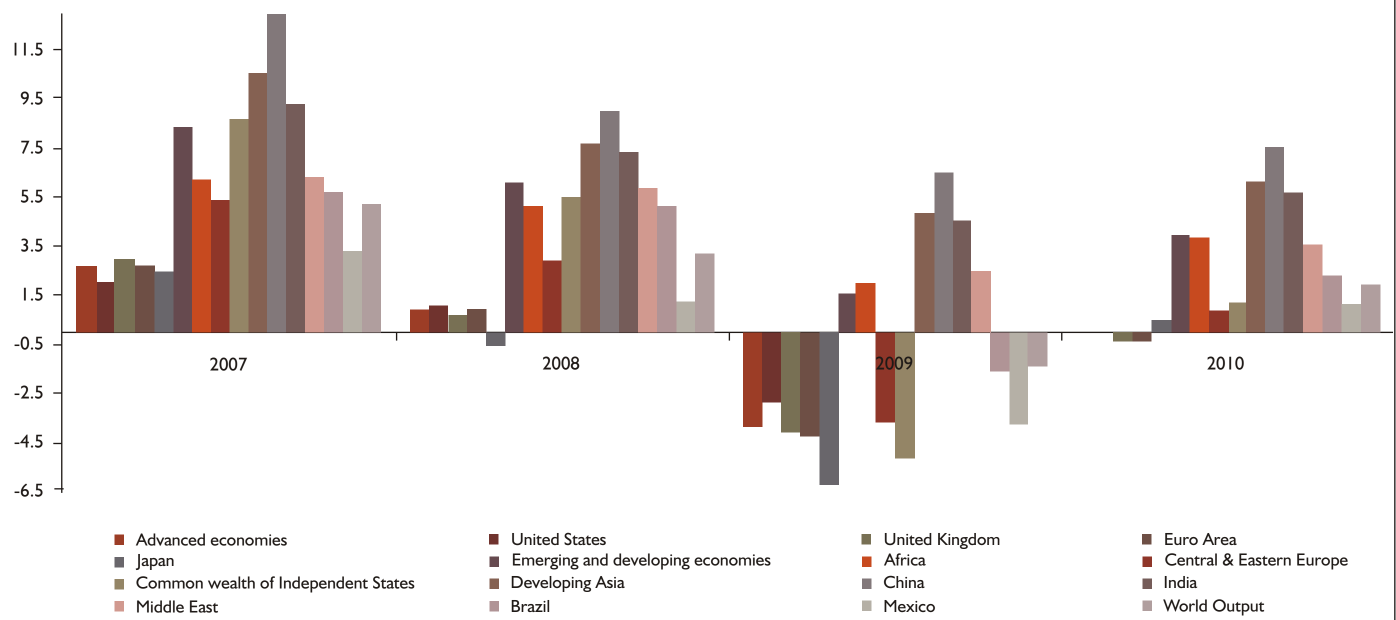

Figure 1: World Output Growth Trends - Major regions and countries

- Projected write-downs on U.S.-originated assets by all financial institutions over 200710 have been increased by $0.5 trillion from the estimate of $2.2 trillion in Jan 2009 due to the worsening economic environment. Total expected write-downs on global exposures are estimated at about $4 trillion, of which two-thirds will fall on banks and the remainder on insurance companies, pension funds, hedge funds, and other intermediaries.
- Commodity prices fell sharply from midyear highs. The losses were largely borne by the Middle Eastern and CIS economies and commodity exporters in Latin America and Africa.
- Globally, bank credit and access to private capital access to be limited as uncertainty about institutional solvency augments funding strains. Funding strains have spread beyond short-term bank funding markets in advanced economies as many nonfinancial corporations are unable to obtain working capital, and some are having difficulty raising longer-term debt.

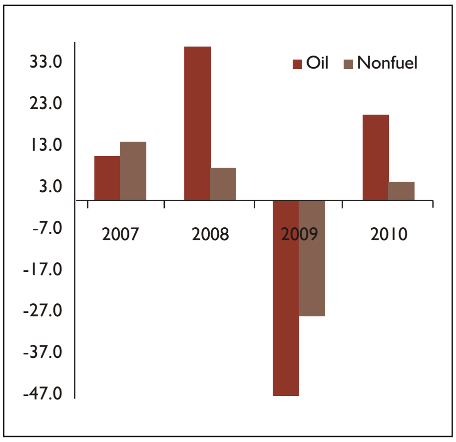

Figure 2: Commodity Prices (in US dollars)

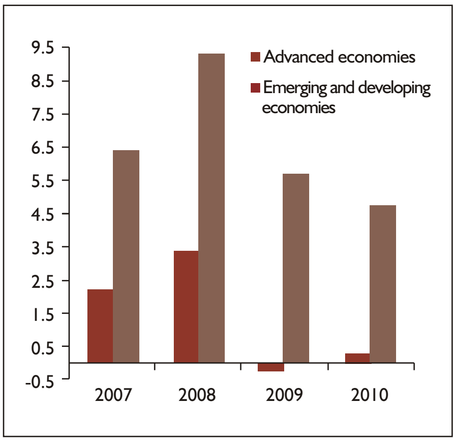

Figure 3: Consumer Prices

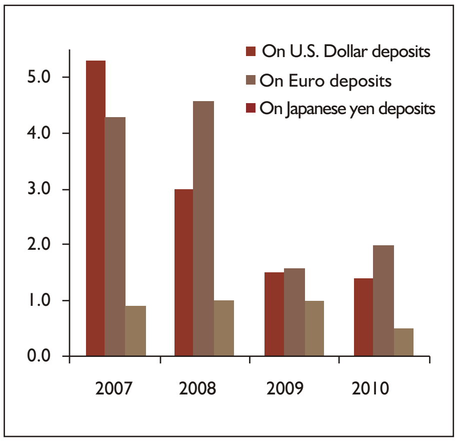

Figure 4: London Interbank rates (%)

- The deepening economic recession has contained wage increases and eroded profit margins. 12-month headline inflation in advanced economies fell below 1% Feb 2009. Inflation also moderated significantly across emerging economies, though in some cases falling exchange rates dampened the downward momentum.
- An important side effect of the financial crisis has been a flight to safety and return of home bias, impacting the world's major currencies. Since September 2008, the U.S. dollar, euro, and yen have all strengthened in real terms. The Chinese Renminbi and currencies pegged to the dollar (including those in the Middle East) have also appreciated. Most other emerging economy currencies have weakened sharply, despite the use of international reserves for support.

Outlook and Risks

- Financial market stabilization will take longer than previously envisaged. Financial strains in the mature markets are projected to remain until 2010, improving slowly as greater clarity over losses on bad assets and injections of public capital reduce insolvency concerns, lower counterparty risks and market volatility, and restore more liquid market conditions.
- Overall credit to the private sector in the advanced economies is expected to decline in both 2009 and 2010. Emerging and developing economies are expected to face curtailed access to external financing in both years.
- Strong macroeconomic policy support is envisaged. Monetary policy interest rates are expected to be lowered to or remain near the zero bound in the major advanced economies, while central banks continue to explore ways to use both the size and composition of their balance sheets to ease credit conditions.
- Fiscal deficits are expected to widen sharply in both advanced and emerging economies, as governments implement fiscal stimulus plans amounting to 2% of GDP in 2009 and 1.5% of GDP in 2010.
- Commodity prices remain close to current levels in 2009 and rise only modestly in 2010, consistent with forward market pricing.
- Global activity is now projected to decline by 2% in 2009. Output per capita is projected to decline in countries representing three-quarters of the global economy, and growth in virtually all countries has decelerated sharply from rates observed in 200307.
- Growth is projected to re-emerge in 2010, but at just 1.5%.
- Key transmission channels include (a) rising corporate and household defaults that cause further falls in asset prices and greater losses across financial balance sheets; and (b) new systemic events that further complicate the task of restoring credibility.
- Fiscal and monetary policies may fail to gain traction, since high rates of precautionary saving could lower fiscal multipliers, and steps to ease funding could fail to slow the pace of deleveraging.

Policy Challenges

The severe impact of the global recession requires definitive financial and macroeconomic policy actions. Previous financial crisis have shown that delayed policy actions have aggravated the economic downturn with greater costs, both in terms of taxpayer money and economic activity. Initiatives that support trade and financial partnersincluding fiscal stimulus and official support for international financing flowswill help support global demand, with shared benefits.

Table 2: Key Policy Challenges resulting from the Global Recession that are being adopted across Global Markets

Financial Sector Restructuring	Monetary Policy	Fiscal Stimulus with Sustainability
■ Establishment of common basic methodologies for the realistic valuation of securitized credit instruments. ■ Quick recapitalization of viable banks that have insufficient capital with capital injections from the government to bring capital ratios to a level sufficient to regain market confidence. ■ Some countries have extended guarantees of bank debt to firms, focusing on those associated with export markets, or have provided backstops to trade finance through various facilitieshelping to keep trade flowing and limiting damage to the real economy. ■ Greater international cooperation to avoid exacerbating cross-border strains. Coordination and collaboration is particularly important to avoid adverse international spillovers from national actions.	■ Lower interest rates to be supported by increasing recourse to less conventional measures, using both the size and composition of the central bank's own balance sheet to support credit intermediation. ■ Emerging economies borrow more heavily in foreign currency, and large exchange rate depreciations can severely damage balance sheets. Thus, most central banks in these economies have lowered interest rates cautiously to maintain incentives for capital inflows and to avoid disorderly exchange rate moves. ■ The pace of withdrawal of the extraordinary monetary stimulus needs to be carefully balanced. Acting too fast would risk undercutting a fragile recovery, but acting too slowly could risk overheating and inflating new asset price bubbles.	■ Governments are faced with a difficult balancing act, delivering short-term expansionary policies but also providing reassurance about medium-term prospects. ■ Fiscal consolidation will be facilitated by strong medium-term fiscal frameworks once a recovery has taken hold. ■ Countries with fiscal room will introduce new stimulus measures to support recovery as government stimuli will need to be at least sustained, if not increased, in 2010. ■ Increased focus on measures that bring long-term benefits to the economy's productive potential, such as spending on infrastructure are envisaged. ■ Fiscal stimuli will attempt to balance short-term initiatives with reforms to strengthen medium-term fiscal frameworks to provide reassurance that short-term deficits will be reversed and public debt contained.

India's Trade Linkages with the World Economies

2008-09 was marked by adverse developments in world trade reflecting the impact of the slowdown in global demand, reversal of capital flows and reduced access to external sources of finance for both advanced and emerging economies including India. Economies were affected in varying degrees depending upon the extent of openness and dependence on capital flows. While export growth in real terms decelerated in the United States and the European Union, import growth continued to be high in natural resource rich countries like CIS, Africa, Middle East, besides India though it decelerated slightly.

India's Trade Linkages with the World Economies

- India's exports contribute around 20% of it's domestic production. Net exports have contributed -29.5% to GDP growth over the last year.
- Performance of exports and imports for world and some major trading partners of India in 2008-09 show an initial good growth in the first period becoming negative in the second period and worsening to be highly negative for the third period.

Table 3: Growth rate of major trading partners of India (2008-09), US$ terms

	Exports			Imports		
	Apr-Aug 08	Sept-Dec 08	Jan-Mar 09	Apr-Aug 08	Sept-Dec 08	Jan-Mar 09
World	16.5	-3.7	...	18.1	-2.2	...
USA	19.8	-0.9	-22.3	14.9	-4.4	-29.9
Hong Kong	7.9	-0.1	-18.3	9.5	-1.5	-21.2
Singapore	16.9	-6.2	-40.2	23.5	0.5	-35.8
Japan	16.4	-5.1	-40.6	28.7	13.5	-29.0
China	23.0	8.6	-19.7	30.6	-1.6	-30.8
India	29.5	-3.6	-24.1	40.9	16.2	-25.5

- The directional pattern of India's trade has changed during the decade. Trade with the top 16 trading partners increased by over 3.6 percentage points since 2003-04 to 58.9 percentage share of total in 2007-08.
  - The share of the United States, the largest trading partner, declined by 1.5 percentage points to 10.1% in 2007-08, while that of the United Kingdom and Belgium declined by 1.6 and 2 percentage points, respectively.
  - The share of China (the second largest partner in 2007- 08) increased to 9.2% in 2007-08 from 4.9% in 2003-04. China became India's largest trading partner in Apr-Feb 2008 with trade share of the United States falling drastically by 2 percentage points compared to 2007-08.

Table 4: India's trade and export/ import ratio with major trading partners

S.No.	Countries	Share in Total Trade (%)						Export/Import ratio		
		2003-04	2004-05	2005-06	2006-07	2007-08	2008-09 (Apr-Feb)	2006-07	2007-08	2008-09 (Apr-Feb)
1	China	4.9	6.5	7.0	8.3	9.2	8.6	0.5	0.4	0.3
2	USA	11.6	10.6	10.6	9.8	10.1	8.2	1.6	1.0	1.2
3	UAE	5.1	6.1	5.1	6.6	7.0	8.1	1.4	1.2	1.0
4	Saudi Arabia	1.3	1.4	1.4	5.1	5.6	5.6	0.2	0.2	0.2
5	Germany	3.8	3.5	3.8	3.7	3.6	3.6	0.5	0.5	0.6
6	Singapore	3.0	3.4	3.5	3.7	3.7	3.3	1.1	0.9	1.1
7	UK	4.4	3.7	3.6	3.1	2.8	2.6	1.3	1.4	1.0
8	Hong Kong	3.3	2.8	2.6	2.3	2.2	2.6	1.9	2.3	1.1
9	Korea	2.5	2.3	2.5	2.3	2.1	2.5	0.5	0.5	0.4
10	Japan	3.1	2.7	2.6	2.4	2.5	2.3	0.6	0.6	0.4
11	Belgium	4.1	3.6	3.0	2.4	2.1	2.2	0.8	1.0	0.8
12	Indonesia	2.3	2.0	1.7	2.0	1.7	2.0	0.5	0.4	0.4
13	Italy	2.0	1.9	1.7	2.0	1.9	1.8	1.3	1.0	0.9
14	South Africa	1.7	1.6	1.6	1.5	1.5	1.6	0.9	0.7	0.3
15	France	1.7	1.8	2.5	2.0	2.1	1.3	0.5	0.4	0.9
16	Brazil	0.4	0.8	0.8	0.8	0.8	0.9	1.5	2.7	2.2
	Total (1 to 16)	**55.3**	**55.0**	**54.1**	**58.1**	**58.9**	**57.1**	**0.8**	**0.7**	**0.6**

- With rising POL prices resulting in higher import values and India's rising exports of refined POL products, the United Arab Emirates (UAE) and Saudi Arabia have emerged as the third and fourth largest trading partners of India.

- Though India had a large overall trade deficit, it had a trade surplus with the United States, UAE, United Kingdom, Hong Kong, Belgium, Italy and Brazil in 2007-08. During 2008-09 (Apr-Feb), India had a trade surplus with US, UK, Singapore, Brazil and Hong Kong. The largest trade deficits were with Saudi Arabia and China. India's export-import ratio with Brazil stabilized at above 2%.

- An additional decline in output growth due to international trade linkages has evolved as the biggest challenge as these interactions have already led to such an abrupt slowdown in activity and have intensified stress since Sep 2008.

- In 2008-09 (Apr-Feb), Asia and ASEAN continued to be the major source of India's imports accounting for 61.7% of total imports. Country-wise, imports from UAE and China recorded high growth of 39.1% and 13.3% respectively. Growth of imports from EU-27 (with a share of 13.5%) was at 12.3% and from North America (with a share of 6.7%) at 27.0%.

- In terms of export destination, the United States continued to be the principal destination accounting for 12.0% of India's total exports in 2008-09 (Apr-Feb), followed by UAE (10.8%), China (5.1%), Singapore (4.8%), Hong Kong (3.7%) and U.K. (3.6%). Region-wise, over half of India's exports were to Asia (including ASEAN), up from around 40% in 2001-02. During 2008-09 (Apr-Feb), exports to Asia (including ASEAN) grew by 6.9%, to Europe by 10.2% and to the United States by (-) 1.6%. India's merchandise exports to South Asian countries declined by 5.2%.

Table 5: Decline in Output growth due to international trade spillovers in 2009-10

Countries	United States	Euro Area	Japan	Emerging Asia	Latin America	Emerging Europe
Percent	63%	48%	61%	78%	40%	41%

Impact and Challenges of Trade Linkages on the Indian Economy

- India's exports are expected to be adversely impacted as import demand from major trading partners continues to decline.

- Imports and local industry would be positively impacted by the fall in petroleum prices and cooling in commodity prices.

- India and China are among the top 10 exporters of commercial services in the world in 2008 (the rest being the advanced economies) in the US$ 3.7 trillion world export of commercial services.

- Developing countries (39.9%) are the largest markets for Indian exports followed by OECD countries (38.2%) and OPED countries (19.9%). USA with an export market of 12% continues to be the single largest export destination. The other major markets for Indian exports are the UAE (10.8%), China (5.1%), Singapore (4.8%), Hong Kong (3.7%) and U.K. (3.6%).

- Projected reduction in world output is at 2% and World Trade Volume at 11% for 2009. In 2010, an economic recovery is expected in the second half with a growth in world output of 1.5% and world trade volume of goods and services of 6%

- World export and import growth of services decelerated from 19% and 18% respectively to 11% in both cases. The deceleration was similar in most of the major regions like North America, Europe and Asia. Deceleration of import growth of services in the United States at 7% and in EU by 9% was particularly sharp.

- General credit extended by the companies has been badly affected by the financial crisis due to the general pessimism about the companies and the prices of their assets. International banks started adopting a cautious approach, in the wake of financial market turmoil, and reduced the "bank limits" or "country limits." As a result, the cost of trade finance in developing countries went up by 3- 4%.

- Trade financing has been used in more than 90% of trade transactions (mostly short-term credit) in the world. The global financial crisis, which has resulted in slowdown in economic growth, has also impaired the access to trade finance. Developing and emerging economies are most vulnerable to the shortages in trade finance.

Policy & Trade Reforms impacting International Trade within the Indian Economy

For the merchandise trade sector:

- Continuation of the reduction in customs and excise duty to make Indian exports and industry competitive.
- Streamlining of existing export promotion schemes.
- Special attention to export infrastructure along with rationalization of port service charges based on services rendered by ports in tune with our competing countries.
- Weeding out unnecessary customs duty exemptions.
- Rationalizing the tax structure including specific duties in a calibrated manner taking into account the specific duty levels in our trading partner countries.
- Checking the proliferation of SEZs.
- Clear-cut policy for beneficial CECAs even with some developed countries instead of just FTAs/PTAs.

In the services sector a road map of specific policies is being drawn not only to overcome the impact of the current global crisis, but also to accelerate the growth of the economy and total exports, as this sector has been showing a steady and promising performance with relatively lesser support compared to merchandise sector.

Other measures include:

- Streamlining domestic regulations like licensing requirements and procedures, qualification requirements and procedures, technical standards and regulatory transparency to help in the growth and export of services is being undertaken.
- Negotiations with our major trading partners will help in increasing our market access

Economic Prospect for Indian Exports

- Exports account for over 20% of India's domestic production. An increase in export potential can be expected to augment domestic demand both directly and indirectly thereby increasing domestic employment and manufacturing growth.
- On a global basis, imports have reduced from 18% to 11% in 2009. As oil and essential commodities are largely inelastic in volume, reduction in imports impacts non essential commodities. Thus, Indian exports declined due to reduced imports by trading partners.
- In order to restore and increase India's export share, it is essential to (a) to explore new international markets; and (b) address competition from other exporting countries. While developing countries are the largest market for Indian exports, OECD and OPED countries constitute a close second.
- A combination of trade/ policy reforms, government's focus in the budget coupled with improved export infrastructure is expected to revive export growth thereby improving the trade and current account deficit and contributing to growth in India's GDP.
- The Government has taken a number to direct steps in the 2009-10 budget in addition to trade and policy reforms to restore export growth including enhanced ECGC cover to badly hit sectors; increased allocation for MDA Scheme to support exporters in developing new markets; insulated employment-oriented export sectors from the global meltdown and created a special fund to SIDBI to incentivize lending to Micro MSEs.

The Union Budget (2009-10)

The Union Budget presented by the newly formed Government attempted to meet the challenges posed by the continuing global economic uncertainty. As burgeoning fiscal deficit continues to limit the scope of counter-cyclical measures seeking to stimulate economic growth, the Budget's overarching priorities continue to be revival of sustainable economic growth and inclusive development with a focus on infrastructure and social sectors.

Table 6: Main Highlights of the Union Budget (2009-10)

Growth

- IIFCL given greater flexibility to take care of asset liability mismatch; free up capital for financing new projects and facilitate incremental lending to infrastructure sector.
- IIFCL to refinance up to 60% of loans by commercial banks for PPP projects, and evolve "take-out" financing for infra projects.
- IIFCL will finance 50% of projects (total investment of Rs. 1 trillion). Public investment in infrastructure to get a big boost.
- 23% increase in budgetary allocation to highways and railways (increased by Rs. 15,000 cr.).
- JNUURM allocation increased by 87%.
- Mumbai drainage allocation increased.
- Accelerated power development and reform programme: Rs. 2,080 crore (160% increase in allocation).
- Natural gas: long distance highway to facilitate a national gas grid.
- Scheme for urban poor housing increased to Rs. 3,973 crore.
- Agriculture: Loans will go up from Rs. 2.87 trillion to Rs. 3.25 trillion; continuing interest subsidy scheme for farmer; govt. to pay additional 1% subsidy to those who paid their loans on time Rs. 411 crore over the February interim budget.
- Farm loan waiver covered 40 million farmers; six months extension on account of delayed monsoon. Maharashtra loan waiver coverage will be reviewed by a task force.
- Accelerated irrigation development programme: 75% increase in allocation.
- Extension of the debt waiver scheme towards maintaining agricultural growth at 4%.

Reforms

- Return to deficit targets post overcoming negative effects of the global economy. 13th finance commission to create a new roadmap in October.
- To bring fiscal deficit under control need institutional controls; will cover subsidy, expenditure and disinvestments.
- Fertilizer subsidy: a nutrient based subsidy scheme as opposed to product based scheme; subsidy to be transferred directly to farmer.
- Direct tax reforms: Simplify returns form. FM stresses tax system that generates revenue on a sustained basis. More reforms spread over 5 years.
- Oil and petroleum subsidy: Three-fourths of our oil consumption is met through imports. Task force to decide on oil pricing. Setting up of an expert group to advise on a viable and sustainable pricing system for petroleum products, to bring it in line with the global markets;
- Disinvestment: More shares to be offloaded to individuals; banks/insurance to remain in public sector.
- Average public float of companies should be expanded from current 15%. FM proposes to raise level of public shareholding.

Inclusive Growth

- Increase in allocation for NREGA to Rs. 39,000 crore.
- National food security act work has begun; 25kg of rice at Rs. 3 per kg.
- Increased spending of up to 144% on the National Rural Employment Guarantee Scheme that guarantees 100 days of work every year to each poor family.

Restoring Exports

- Extension of Adjustment assistance scheme to provide enhanced ECGC cover at 95% to badly hit sectors up to March 2010.
- Enhanced allocation for MDA Scheme by 148% over 2008-09 B.E. to Rs.124 crore to support exporters in developing new markets.
- Special fund to SIDBI of Rs. 4,000 crore to incentivize lending to Micro MSEs by refinancing 50% of incremental lending.
- To insulate employment-oriented export sectors from the global meltdown, an interest subvention of 2% on pre-shipment credit for seven such sectors (textiles including handlooms, handicrafts, carpets, leather, gems and jewellery, marine products and small and medium exporters) up to March 2010.

  Services received by exporters from goods transport agents and commission agents would be exempted from service tax.
- For other services received by exporters, the exemption would be based on self-certification of the documents where such refund is below 0.25% per cent of fob value and certification of documents by a Chartered Accountant for value of refund exceeding the above limit.
- The Export Promotion Councils and the Federation of Indian Export Organizations (FIEO) are exempt from service tax on the membership and other fees collected by them till 31st March, 2010.

Understanding the Impact

- Government spending to revive economic growth that has declined sharply due to the current demand-deficient state of the economy caused by a significant decline in exports and private consumption.
- Increased government spending (36%) will aggravate the already adverse fiscal balance. The cost of extra spending (in light of decreasing tax revenues) is expected to increase the fiscal deficit to 6.8% coupled with interest payments at one-fifth of total government expenditure.
- Policy measures targeted at increasing private consumption include (a) increase in disposable incomes by stepping up welfare, infrastructure and social sector schemes; (b) income tax relief on personal income to augment consumption; and (c) proposals to make consumer goods and services cheaper to incentivize sales and boost demand.
- Increased budgetary allocations on rural development (45%) and infrastructure (9%) to step up gross fixed capital formation (investment).
- While measures to contain decline in exports are expected to stabilize growth, the Market Development Scheme is expected to promote market expansion and diversification to help exporters overcome the challenges of drastic international trade volume reductions.
- Fiscal policy to strike a balance between revival of high economic growth (critical to generate the revenues needed social welfare objectives on a sustained basis and inclusive growth) and worsening fiscal deficit.

The impact of the Budget is felt through it's impact on key sectors/ industries. Major impetus has been given to industries including fertilizers, capital goods, infrastructure and certain consumer goods.

Table 7: Budget Proposals for main Sectors/ Industries

Sectors	Industries	What the Budget proposes
Agriculture, Forestry & Fishing	**Fertilizer**	‣ Nutrient based subsidy over current product based subsidy. Budgeted subsidy in 2009-10 is Rs. 499.80 bn. (2008-09: Rs. 958.49 bn. RE; Rs. 309.86 bn. BE). ‣ Thrust to agriculture to grow at a 4% annual rate. ‣ Thrust on irrigation schemes and farm loan waiver extension.
Manufacturing	**Capital Goods**	‣ Increased allocation/long term funds availability for power, infrastructure & and housing projects. ‣ Long-term refinancing facilities for infrastructure projects. ‣ Reduction in duty on ferromagnets for windmills for above 0.5 MW. ‣ Increase in custom duty on concrete batching plants from 0% to 7.5%.
	Steel	‣ Development of a blueprint for a long distance gas highway. ‣ Extension of section 80-IB(9) to the natural gas sector. ‣ Significant increase in outlay on rural housing and urban infrastructure.
	Auto/ Auto Ancillaries	‣ Reduction in ED on: ▪ Large passenger cars and utility vehicles with engine capacity of 2,000 cc and above from Rs. 20,000 per vehicle to Rs. 15,000 per vehicle. ▪ Petrol driven trucks from 20% to 8% bringing it in line with diesel driven vehicles. ‣ Allocation for NHAI increased by 23% from Rs. 129.66 billion. ‣ Roll-out of the GST regime by April 1st, 2010.
	Pharmaceuticals	‣ Custom duty reductions on certain life saving drugs and specified life saving devices. ‣ Countervailing excise duty exemption for influenza vaccine and specified life saving drugs (including bulk drugs used for these).
Electricity, Gas & Water Supply	**Oil & Gas**	‣ Expert Group on pricing petroleum products. ‣ Blueprint for long distance gas highways leading to a national gas grid. ‣ Investment linked tax incentives for laying and operating cross country natural gas or crude or petroleum oil pipelines for distribution on common carrier principle. ‣ Extension of section 80-IB(9) to the natural gas sector.
	Power	‣ Significant increase in allocation under APDRP and RGGVY. ‣ Extension of Section 80 IA benefits till March 2011. ‣ Increase in MAT rates from 10% to 15%.
Construction		‣ Increased budgetary outlay for Bharat Nirman, NHAI and JNNURM. ‣ Increase in MAT rate from 10% to 15% of book profit. ‣ Refinancing of commercial bank loans for PPP projects by IIFCL and take-out financing initiatives. ‣ Restoration of full exemption on goods used for further construction.
Trade & Hotels	**Hotels**	‣ 64% increase in allocation for the 2010 Commonwealth Games from Rs. 21.12 bn. To Rs. 34.72 bn. ‣ Elimination of Fringe Benefit Tax (FBT).
	Retail	‣ A clear roadmap for implementing Goods and Services Tax (GST) w.e.f April 1st 2010. ‣ Introduction of investment-linked tax incentive for "cold-chain" and warehousing facilities for storing agriculture produce.
Transport & Communication	**Roads & Ports**	‣ Increased allocation for NHAI & social sector programmes under Bharat Nirman. ‣ IIFCL to evolve a takeout financing scheme and refinance 60% of commercial bank loans for PPP projects. ‣ Increase in the rate of MAT to 15% from 10%; however the time period for carrying forward the tax credit under MAT extended to 10 years from 7 years.
	Aviation	‣ IIFCL to evolve a takeout financing scheme and refinance 60% of bank loans for PPP projects.
	Telecom	‣ Extension of exemption from special additional customs duty on components and accessories of mobile handsets (including cell phones) for a period of one year. ‣ Abolishment of the fringe benefit tax (FBT). ‣ Minimum alternate tax (MAT) has been increased from 10% to 15%.
Financing, Real Estate & Housing	**Real Estate**	‣ Overall increase in allocation for programs like Rajiv Awaas Yojana (RAY) and Indira Awaas Yojana (IAY). ‣ Allocation of Rs. 20 billion for Rural Housing Fund in the National Housing Bank (NHB).
	Information Technology	‣ Extension benefits under Section 10A/ 10B and EoU units by one more year. ‣ Creating safe harbour provision in transfer pricing regulation. ‣ Introduction of fast-track tax dispute resolution mechanism. ‣ Abolition of duplicity of indirect taxes for software licensing.

The Road Ahead...

- *Timelines for a full global recovery seemunusually uncertain as the sharpdecline in GDP,industrial production and trade both in 2008 and Q1 2009 are unprecedented and further complicated by the extent to which this cycle has been globally synchronized and the fragility ofthe financial sector.*
- *Incipient signs of stabilization in North America and Euro centre (revival of consumer demand, increased real estate sales, stock market rebounds) and recovery in Asia and Latin America (increase in industrial production, acceleration of credit supply and sharpgains in government spending) are coupled with indicators ofrecession leadingto increased unemployment and negative wealth effects.*
- *As enhanced public spendingemerges as one ofthe key factors sustaininggrowth,rebalancing growth drivers away frompublic spendingtowards exports and consumption becomes increasingly crucial to create a sustainable growth momentum. A strengtheningof export and consumer demand can be expected to drive global industrial production thus counteractingrecessionary forces.*
- *India expects to stabilize economically in 2009 with a straight-line GDP growth of6.8% facilitated by an economic recovery in several trading partner countries,improved risk perception ofIndian investments and lower domestic lendingrates.*
- *Surplus food stocks will continue to balance agriculture and allied activities.*
- *Increased fiscal spendingwill boost demand, impair business confidence, add to an increasingfiscal deficit and curtail private credit and investment.*
- *As industry accumulates a substantial excess capacity,export- led demand is the key to sustained recovery in industrial production.*
- *An increase in exports is expected in line with recuperation in global trade by 2010,and will be supported by a reduction in trade and current account deficits due to diminution in imports.*
- *Export-led growth becomes increasingly important as domestic demand is dampened by consumer and investor reluctance to borrow,spend or invest as prolonged recession lowers confidence.*
- *With global trade and business cycles beginningtheir slow journey towards recovery, economies need to reviewtheir strategies and policies to synchronize their own revival. Diversification oftrade linkages and export-led growth continue to be one ofthe main drivers to rebalancing economic growth,fuellingindustrial production and creatingan iterative positive impact on other demand drivers.*

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