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India – Silent but powerful reforms

• We review the NDA government’s policy actions as it nears the end of its first six months
• The pace of decision-making has picked up, though ‘big-bang’ reforms are delayed
• ‘Silent’ reforms to improve the ease of doing business are important, but cyclical headwinds might delay their impact
• Simplifying land acquisitions, introducing GST will be the focus of the winter session of parliament
• Silent reforms could push GDP growth towards 6%; more macro reforms are needed for higher growth

Summary
As the National Democratic Alliance (NDA) government approaches the end of its first six months in office, we take a close look at its policy initiatives during this period and compare them with our expectations. After the NDA was elected in May 2014, we outlined probable government announcements in the next 6-12 months (On the Ground, 26 May 2014, ‘India – Agenda for the new government’). We expected the policy stance to be mildly centre-right, with a focus on reducing bureaucratic red tape.

Reforms started slowly. Budget proposals announced in July indicated no clear direction for reforms, and markets were largely disappointed that the government did not use its political capital to push through unpopular but necessary changes. However, more announcements were gradually made after the budget, initially focused on micro-level initiatives to improve efficiency rather than broad macro initiatives. These micro reforms – often called ‘silent’ reforms – are aimed at improving the ease of doing business in India. They will add credibility to Prime Minister Narendra Modi’s invitation to foreign companies to participate in the ‘Make in India’ campaign, which aims to encourage the manufacturing of products in India for export.

The government has introduced further macro reforms since the Bharatiya Janata Party (BJP), which leads the NDA, won two important state elections in October. The process is likely to gather pace as we head into the winter session of parliament starting on 24 November. In line with our expectations, initiatives so far include an emphasis on reviving stalled projects, a commitment to fiscal consolidation via further deregulation of fuel prices, the reduction of red tape, further opening of the economy by liberalising FDI rules, and short-term measures to improve food supply.

Progress on labour reforms, the relaxation of procedurally complex environmental rules, and the removal of bottlenecks in the energy sector have exceeded our expectations. Unfinished agenda items for the NDA government include indirect tax reforms, a review of land-acquisition rules, supply-side measures to achieve medium-term food price stability, measures to ensure stable and reliable supply of power, banking-sector reforms, divestment of public-sector companies, and a plan to revive manufacturing growth.

In this report, we present a comprehensive summary of actions taken by the new government so far. We think the government is on the right track and the role of silent reforms in improving India’s productivity should not be ignored. Such reforms could push India’s GDP growth to around 6% (from below 5% in FY14, year ended March 2014), with a lag. However, the government needs to accelerate unfinished reforms in order to increase growth potential further.

We provide a snapshot of the government’s policy actions so far in Figure 1.

Important disclosures can be found in the Disclosures Appendix
**Figure 1: Status report on the progress of NDA government’s actions/policies**

*Policies/actions compared to our expectations in May*

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*Source: Standard Chartered Research*
**De-bottlenecking growth**

The NDA government inherited a slew of projects facing regulatory hurdles, and there was often a lack of clarity on the regulations involved. Below, we outline the steps taken by the government to remove these bottlenecks.

**Fast-tracking project approvals**

Restarting stalled projects has been a priority for the new government. The Project Management Group (PMG) set up by its predecessor had approved 181 of almost 500 projects under its consideration (primarily related to environmental and forest clearances and ensuring the supply of coal) in 15 months. Of these, about 40 have been cleared by the new government, and some of the 181 approved projects are now getting off the ground.

Changes made by the new government to the operations of the PMG include the following:

- The PMG now not only sets timelines for actions by ministries, but also monitors progress. Previously, monitoring was done by the Department of Financial Services. The PMG is now in effect a single authority that coordinates approvals from different ministries, and is directly monitors the progress of projects.

- In line with the central government PMG, 17 states have created their own PMGs and connected them through a single portal for better coordination. These state PMGs are now able to track projects with investments between INR 0.5bn and INR 10bn, increasing the number of projects that are tracked. This is in addition to the central government PMG, which tracks projects with investment above INR 10bn.

**Relaxing environmental clearances**

Around 10% of the project delays are due to a lack of environmental clearances. A four-member committee has been set up to modernise five key environmental laws concerning protection and conservation of the environment, forest, wildlife, water and air. The committee’s deadline has been extended by a month to end-November.

While this committee has been deliberating on large-scale changes to the regulatory framework, the government has announced several simplifications of procedures at the micro level. We consider these to be part of the ‘silent’ reform effort. They include the following:

- Coal mines can now expand their capacity (up to a fixed limit of 50% of current capacity) without consulting those affected in a public hearing. Bigger mines with output of more than 16 million tonnes per annum (mtpa) can increase capacity by 5mtpa. In the past, public hearings were often disrupted by villagers and NGOs. Combined environmental clearances will now be granted for coal mines that are in close proximity to each other, rather than separate approvals for each one.

- Irrigation projects of less than 2,000 hectares no longer need environmental clearance. For those between 2,000 and 10,000 hectares, state approval is sufficient; central government approval is no longer required.

- For several other industries (thermal coal, paper pulp, mining, polluting industries near national parks), state governments have been given greater powers to grant environmental clearances.
Prospecting for minerals in forest areas will not require tribal consent or compensatory afforestation, and government inspection of these activities will not be required (for projects up to 100 hectares).

Rights to forest land will now be determined more by the district administration rather than by tribal village leaders.

The ban on new industries in critically polluted areas has been lifted, with the government reconsidering the pollution index-based moratorium.

The Environment Ministry has also released a draft notification under which infrastructure projects will not have to seek approval from environment impact assessment (EIA) authorities at the state level.

In October, the government eased the provisions of the Forest Right Act (FRA). Under the new rules, a project will have to apply for FRA compliance only if the area was declared a forest before 1930 and a tribal group lived there according to the previous two census surveys. This could accelerate numerous projects, allowing them to use the land for industrial purposes without having to obtain approval under the FRA.

Environmental and forest clearances can now be tracked online. The government also plans to grant environmental and forest clearances for a project simultaneously. The earlier approach of awarding environmental clearance first, before an application could be made for forest clearance, led to delays.

**Moving to a different model in the road sector**

One of the most significant announcements by the new road minister has been the move from the build, operate, transfer (BOT) model for public-private partnership (PPP) projects to the government-funded engineering, procurement, construction (EPC) model for the next two years. The intention is to provide relief to cash-strapped and highly leveraged road developers. Other measures to help them include a facility to reschedule premiums due to the government (announced by the previous government) and allowing developers to exit from projects early (under consideration by the current government). To support the move to the EPC model, budgetary resources for the road sector have been increased by about 14%. A target of 8,500km of highway construction has been set for FY15.

The NDA government inherited 189 road projects worth INR 1.5tn that were stalled owing to regulatory hurdles. Many were approved by the roads ministry within the first month of the new administration. Also, in the case of 34 projects worth INR 385bn, developers were offered a ‘golden handshake’ to exit, and the projects are now being prepared for re-tendering. However, the ministry has fallen short of its H1-FY15 target: 2,150km of road projects were awarded in H1, versus the full-year target of 8,500km. For nine of 11 PPP projects tendered during the period, the government did not receive a single bid. Nevertheless, progress is much better than in FY14, when only 3,169km of projects were awarded in the full year. Also, tendering started only in August, and the process of converting PPP projects to the EPC model often takes time.

The roads ministry has also drafted a new motor vehicle bill to improve road safety. The bill is likely to be tabled in the winter session of parliament.
**Fast-tracking defence acquisitions**  
In the past, the process of defence acquisitions has faced significant delays because of a multi-layered approval process and allegations of bribery. The new government cleared defence purchases worth INR 800bn (c.USD 13bn) in October after the decision to purchase 37 helicopters in August. Although most of these will have to be imported, the new government is making a concerted effort to source defence equipment domestically. This effort, in conjunction with a relaxation of FDI rules for defence, should further promote Modi’s ‘Make in India’ campaign. Also, to improve transparency, defence purchases worth more than INR 1mn will be made on an end-to-end e-platform.

**Port sector – Renegotiation of PPP projects appears likely**  
The shipping ministry is seeking powers to amend the model concession agreement (MCA) for port projects. Pricing ambiguities are a key reason for delays in port projects. For instance, private terminal operators are pushing for a shift from a royalty-payment model to a revenue-sharing model for government-owned ports. This is because tariff regulation at ports makes them commercially unviable – terminal operators are not allowed to fully pass through the cost of the royalty payment to end users. The shipping ministry partially deregulated tariff rates in 2013, but these guidelines are applicable only to projects awarded since August 2013. Legacy cases need to be dealt with swiftly. In this context, reports that the ministry is considering a mechanism to renegotiate the terms of PPP projects is a positive development, and should provide an impetus for port activity.

**Work on Delhi Mumbai Industrial Corridor (DMIC) is on track**  
The DMIC expects phase 1 of the project to be completed by 2019. This will involve construction of the Dholera Special Investment Region (SIR) in Gujarat and the Shendra-Bidkin Industrial Park in Maharashtra. These are among the eight ‘smart’ industrial cities – cities where information technology is used to achieve sustainable economic development – that are planned along the length of the corridor.

For the Dholera SIR, environmental clearances are in place; the bidding process for basic infrastructure work will begin soon.
Administrative reforms

The most important component of PM Modi’s silent reforms, in our view, is a series of administrative reforms to overhaul the bureaucratic and regulatory structure. The emphasis has been on reducing red tape to attract investors.

Bureaucratic overhaul

Building a well-functioning, accountable bureaucracy that is capable of making quick decisions is a prerequisite for better implementation of government policies. One of the government’s early decisions was to streamline the bureaucracy. This includes:

- Limiting the decision-making process to four layers (no files will be signed by more than four officials)
- Setting a two-week deadline to answer queries
- Seven-slide presentations by bureaucrats to ministers, rather than lengthy reports
- Reducing the length of official forms to one page
- For citizens submitting documents to the government, self-certification is sufficient; no need for verification by government officials
- Creating a website to provide real-time information on which bureaucrats are in the office on a particular day

The government has also undertaken a major reshuffle of senior bureaucrats (close to 50 were transferred on a single day in September), indicating that decisions about their roles will be based on merit and efficiency. The government is working on a proposal to attract candidates from industry and academia to senior administrative government posts starting next fiscal year.

As we had anticipated, the decision-making process has become more centralised under the NDA government, with the Prime Minister’s Office (PMO) playing a bigger role. Its staff has been increased to 64 from 11 under the previous government. The ministerial team is lean, although new ministers might be inducted soon.

Streamlining laws

The new government is making a concerted effort to repeal redundant laws. Every ministry has been tasked with identifying 10 such laws, and we expect the government to propose the repeal of 287 laws in the winter session of parliament. The previous (monsoon) session saw the introduction of the Repealing and Amending Bill (2014) to repeal 36 such acts, and the Law Ministry has identified 1,094 more.

Ease of doing business

PM Modi has stated that improving the ease of doing business in India is essential to the success of his ‘Make in India’ campaign. The Department of Industrial Policy and Promotion (DIPP) has been entrusted with pushing through reforms to improve India’s ranking in the World Bank’s Ease of Doing Business survey from the present low level of 142. The DIPP’s approach is to move towards single-window clearances, make policy and procedures uniform across states, reduce the number of inspections of low-risk businesses, and reduce the burden of filing multiple tax and other regulatory compliance returns. The government aims to reduce the time it takes to register a business to one day from 27 days.
Digitisation plan

The move towards digitisation is a critical component of improving the ease of doing business. Emphasising the need for this, Modi has said: “E-governance is easy governance, effective governance and also economic governance”. The previous government had started work on an integrated e-business platform where all ministries can provide one-stop clearances and accept payments. The NDA government has urged all ministries to join by 31 December.

The government has also launched an ambitious ‘Digital India’ plan to connect the remotest parts of the country through a digital network. Work is progressing on connecting 250,000 local administrative bodies at the village level through high-speed broadband by December 2016. The total outlay for the plan is likely to be close to USD 20bn, spread over four years. Apart from improving the delivery of government services and the connectivity of remote areas, the programme is likely to benefit the spread of e-education, e-health services and e-commerce in India.

Labour reforms

Labour reforms are important to accelerating economic activity and improving India’s Ease of Doing Business ranking. Some labour laws – 44 such laws at both the national and sub-national level – are perceived by industry bodies to be less employer-friendly. To avoid this complex legislation, employers tend to remain small and create less productive or low-income jobs. Such jobs lack the security, compensation and protection that the regulations aim to provide, leaving workers more vulnerable.

The new government is trying two different approaches to labour reforms, as both the central and state governments have the power to legislate on this subject. On the one hand, the BJP-led government in Rajasthan has proposed a set of labour reforms that is awaiting presidential approval. On the other hand, the central government has submitted several proposed amendments to labour laws to parliament and is awaiting upper house approval.

The Rajasthan government proposes the following changes to three labour laws: the Factories Act, the Industrial Disputes Act and the Contract Labour Act. The changes have been approved by the Rajasthan Assembly; after the president approves them, any other state will be free to adopt them. Under Article 252(2) of the Constitution, state law prevails over central government law if the president approves it.

- Government permission to retrench labour should be necessary for companies with more than 300 workers; it is currently required for companies with more than 100 workers.
- A change is proposed to the definition of ‘factory’ under the Factories Act. Only a company employing at least 20 workers (previously 10 workers) will now be defined as a factory and be subject to the provisions of the Factories Act. Under the new definition, almost half of India’s existing companies will not have to comply with the Factories Act.
- The Contract Labour Act should be applicable to companies employing at least 50 workers (up from 20 workers previously).
- A trade union would require the support of at least 30% of workers (previously 15%) in order to be recognised. This would address the problem of too many trade unions in a factory.
At the national level, the central government has proposed 54 amendments to the Factories Act, Apprenticeship Act and Labour Laws (Exemption from Furnishing Returns and Maintaining Registers by Certain Establishments) Act. These include the following:

- To implement Modi’s ‘Skill India’ vision, 500 new trades will be included in the Apprenticeship Act. The addition of IT-enabled services would be particularly positive.
- Companies employing fewer than 40 workers will not have to comply with some of the more stringent labour regulations.
- Restrictions on women working night shifts in factories will be lifted (important for sectors such as textiles and IT).
- The overtime limit for workers will be increased to 100 hours from 50 hours per quarter, providing greater flexibility to employers.

These amendments have been approved by the lower house, and the upper house is likely to decide on them in the winter session of parliament.

The government has also proposed significant changes to the monitoring of labour law compliance. The changes are in line with PM Modi’s mantra of ‘minimum government, maximum governance’.

- Mandatory inspections will be limited, with more focus on voluntary compliance. The 1,800 labour inspectors under four central government agencies will not have discretion in choosing which factories to inspect; rather, a computer-generated list will be provided and they will have to report within three days.
- A portal has been created where employers will be able to submit a self-certified, single compliance report for 16 labour laws.

**Energy-sector reforms**

**Diesel price deregulation**

After gradually increasing the diesel price every month to reduce the gap between domestic and global prices, the government announced a full deregulation of diesel prices in October. In line with the fall in global crude prices, the government announced a reduction of close to 8% in diesel prices (in two stages). The deregulation of diesel prices will be a medium-term positive for the fiscal balance: in FY14, 45% of losses on fuel sales by oil-marketing companies were on account of diesel.

**Auctioning of coal mines**

In September, the Supreme Court cancelled all coal-mining licences granted to private players since 1993. The order affected approximately 10% of India’s coal output, although the court gave the producing mines six months to wind down. Appreciating the gravity of the situation, the government issued an ordinance in October to suggest a way forward. Salient points of the ordinance are as follows:

- The government will use an e-auction process to allocate the coal mines to private players, but can directly allocate coal blocks to public-sector entities. The e-auction process will be completed in the next three to four months.
- At present, only actual users with interests in the power, steel and cement industries can bid for these coal blocks.
The ordinance has an enabling clause that will allow private companies to undertake commercial coal mining in the future without such end-use restrictions for specific industries. This would signal a significant liberalisation and could even encourage foreign companies to consider coal mining in India; however, the government is non-committal about when this will be allowed.

For around 74 cancelled coal mine licences where the mines were operational (or close to operational), the ordinance requires the winning bidders to compensate the existing allottees. This should prevent these mines from becoming non-performing assets.

The proceeds of the e-auctions will go to the states. This will incentivise the states to remove hurdles in areas such as land acquisition.

The railway budget has commissioned three critical railway tracks to ease bottlenecks related to transporting coal. They should be operational by 2016-17. Our Equity Research team estimates that an additional c.290 million tonnes (mt) of mining capacity could be brought on line because of these three lines.

Although these measures are encouraging, more needs to be done to ensure higher growth in coal mining. In particular, the restructuring of the state-owned coal producer has yet to take place; without this, India’s coal-mining efficiency will remain very low. The government also needs to consider the coal price-pooling proposal under which the state-owned coal producer will import coal and blend it with its own stock before selling it to power plants. This will substantially increase coal supply to power plants but will also increase the cost of power, as imported coal is more expensive. The government will have to decide how this additional cost will be distributed between the power producer, the state-level distribution utilities and the central government.

**Natural gas pricing**

The government raised the natural gas price to USD 5.61 per million British thermal units (mmbtu) from USD 4.2mmbtu, effective 1 November. This is much lower than the initially proposed USD 8.41mmbtu. These prices will be revised semi-annually (the initial proposal was for quarterly revisions). This decision had been pending for some time and will provide clarity to producers and consumers. The hope is that higher prices will result in increased supply to gas-based power plants (c.10% of power generation capacity is gas-based) and fertiliser plants, but costs are likely to rise. The government has indicated that a separate price will be announced for deep-sea and ultra-deep-sea gas exploration, which would not be viable at the announced price.

**Steps to manage the food economy**

**Smaller-than-usual increase in MSPs**

This fiscal year, the government has increased minimum support prices (MSPs) by less than has been seen in the recent past.

- The government announced price increases of 1.5-4.0% y/y for the *kharif* (summer) crop, similar to FY14, but significantly lower than the double-digit increases in FY13 and FY10.
- For the *rabi* (winter) crop, the government recently announced price increases of 2.0-4.5%. This is lower than the 9-11% average increases seen over the past eight fiscal years.

We believe a small increase in the MSP will go a long way towards containing price pressure on food-grain and commercial crops.
Release of food grains
Soon after taking power, the NDA government decided to release 5mt of rice through the public distribution system and 10mt of wheat in the open market from its buffer reserves. The regular release of these crops in the market helped to keep prices stable even when India experienced patchy monsoon rains. However, according to some media reports, progress on the release of food grains is slow due to inefficiencies in state supply-chain management.

Tougher stance on hoarders
The new government has taken a tougher stance against food hoarders/middlemen, and has sought to improve co-ordination between the central and state governments on this front. Earlier this year, potatoes and onions were brought under the ambit of the Essential Commodities Act and states were authorised to impose stock limits to prevent hoarding. In light of the recent cyclone-induced panic buying in Odisha, district collectors raided and lodged cases against hoarders to prevent price rises in potatoes, according to media reports. State governments have been advised to amend the Agriculture Produce Marketing Committee (APMC) Act to check monopolistic buying from farmers. In June, the government reiterated its predecessor’s instruction to states to de-list fruit and vegetables from the APMC Act; this change can be implemented by notification, as it does not require legislative amendment of the act. Uttarakhand had already complied with this directive at the beginning of the year, followed by Delhi.

Price stabilisation fund
The government is setting up a INR 5bn price stabilisation fund. The fund will reportedly be operated by the Department of Consumer Affairs (DCA), and will be used by state governments to intervene in the market to counter abnormal price increases for essential perishable commodities including tomatoes, onions, potatoes and pulses. The fund will only be used during the peak summer months. Though the state governments will operate the fund, it can only be deployed by order of the central government. It is unclear how successful such a fund can be given its small size of INR 5bn.

Opening up through more liberalised FDI rules
The cabinet has approved budget proposals to relax rules on FDI in defence, railways, insurance and real estate.

- The ceiling on FDI in defence has been raised to 49% from 26% on the condition that control of joint ventures for manufacturing remains in Indian hands. The government hopes that this proposal will increase domestic manufacturing of defence equipment, of which India currently imports 70% of its requirements; the UK has expressed interest in exploring JV opportunities.

- The cabinet has also approved FDI up to 49% in insurance companies, with the same conditions as above on Indian control. The Insurance Laws Amendment Bill – which includes the liberalisation of FDI rules – is likely to be voted on by parliament in the winter session. It has to be passed by both houses of parliament and the government hopes to achieve this by year-end.

- The cabinet has approved 100% FDI in some areas of railway infrastructure, including high-speed rail, suburban corridors, and dedicated freight corridors. We have yet to receive details on companies planning big-ticket FDI in this sector.
The cabinet has approved the easing of FDI rules in construction, in line with the budget proposal. This entails reducing the minimum built-up area to 20,000 sqm from 50,000 sqm, and lowering capital requirements to USD 5mn from USD 10mn. Both requirements are waived if the investor commits at least 30% of the total project cost to low-cost housing. Though the cabinet has not reduced the three-year lock-in period, foreign investors will now be permitted to exit upon project completion or three years from the date of final investment, subject to the development of trunk infrastructure.

Approach to the social sector

Dismantling the Planning Commission, modifying social programmes

In his 15 August Independence Day speech, Modi announced the dismantling the powerful, 60-year-old Planning Commission and proposed to replace it with a more modern institution. The government appears to be in no hurry to create this new institution, which is likely to be only an advisory body without power to allocate resources. In the absence of the Planning Commission, the finance ministry will take on a greater role in deciding resource allocation between ministries when preparing the budget.

The BJP government is also trying to modify some of the social welfare programmes conceptualised by the Planning Commission. Changes announced to the Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA) are the most prominent of these initiatives. Under this programme, unemployed people are offered a pre-fixed wage to work on government projects for asset creation. The BJP government has changed the ratio of labour costs to material costs under the scheme to 51:49 from 60:40; a number of academic studies and some media reports indicated that the previous ratio did not allow for the creation of productive assets. The scheme will now be available only in undeveloped areas of the country. This change was prompted by the view that MNREGA was discouraging seasonally unemployed people from taking up unskilled jobs in private-sector activities such as construction, leading to a shortage of unskilled labour.

Aadhaar adoption

Contrary to the pre-election perception that the BJP would sideline or discontinue the Aadhaar initiative of providing every citizen with a unique identification (UID) number, verifiable through his biometric details, the new government is exploring the possibility of expanding its use to deliver more services directly to consumers. It has sought to link attendance for government officials to the biometric data provided in their Aadhar UID, and is reportedly planning to link the scheme to its universal health insurance programme to prevent fraudulent claims. It has also linked the scheme to its financial inclusion programme, Jan Dhan Yojana. Once a larger proportion of the population gets a bank account under the government’s new financial inclusion plan, the Aadhaar unique identification system will be more effective in delivering benefits directly to the consumer. According to recent media reports, the Unique Identification Authority of India (UIDAI) has enrolled around 700mn people and issued unique identification numbers to 650mn. The UIDAI has been given a target of 1bn Aadhaar numbers by 2015.
Financial inclusion – Jan Dhan Yojana

Financial inclusion is a cornerstone of the government’s development agenda. This is justified given the nascent state of financial inclusion in India today: according to World Bank data, only 35% of adults (aged 15+) have access to a bank account at a formal financial institution; only 7.7% of adults have had access to a loan from a financial institution over the past year. There are only 8.9 ATMs and 10.6 commercial bank branches per 100,000 adults.

Under the Jan Dhan Yojana programme, the government seeks to provide banking services to all un-banked individuals in India. This entails providing a bank account with an overdraft facility of INR 5,000 (once the account has been active for six months and linked to the account holder’s Aadhar identity number), a debit card and INR 100,000 accident insurance cover. The target for the first phase, ending 26 January 2015, is 75mn bank accounts. On the first day of the programme, 15mn accounts were added. According to press reports, 65mn bank accounts had been opened by 22 October. In the second phase of the programme, the government has proposed a pension scheme for identified individuals in the informal sector and the offer of micro-finance products through government-owned insurance companies.

There is some scepticism about whether this programme will work; under the ‘no frills’ account drive in 2005, millions of accounts were opened but most remained dormant. There are also questions about duplication of bank accounts. However, the government claims that the new programme is a major departure from the previous one, as it focuses on both rural and urban areas (as opposed to only rural previously), and on monitoring and implementation.

Structural changes in the offing

Monetary policy framework agreement (MPFA)

According to media reports, the government is preparing a framework to formally adopt inflation targeting, and a Monetary Policy Committee (MPC) will be established for the first time to set interest rates. This is a positive step; we will closely monitor the following elements.

- What kind of inflation target will the MPFA suggest? Will it be different from the RBI’s suggested ‘glide path’?
- Will the MPFA also suggest growth/employment goals, thereby diluting the RBI’s proposed inflation-targeting framework?
- What will the MPC structure be? The government-appointed Financial Services Legislative Reform Committee (FSLRC) suggested an eight-member committee, while the RBI’s Urjit Patel Committee favours a five-member committee. The FSLRC proposes that the RBI governor, deputy governor and five external members are appointed by the government (two of them in consultation with the RBI governor), and that one government member will not have voting rights. The Urjit Patel committee suggests that the MPC should comprise the RBI governor and deputy governor, one RBI executive director, and two external members to be selected by the RBI governor. The MPFA will have to resolve these divergent views and ensure that the central bank’s independence is respected. According to media reports, the MPFA will be finalised before the budget in February 2015 and the MPC could become operational by April 2015.
Expenditure Management Commission and subsidy reduction

The government appointed an Expenditure Management Commission in August to suggest ways to manage government expenditure, particularly subsidies. The commission is expected to submit its report before the budget in February 2015, and we think some of its suggestions could be included in the budget. The focus is likely to be on reducing fertiliser subsidies by deregulating urea prices, gradually reducing the subsidy on cooking gas, moving towards direct transfer of subsidies via the Aadhaar network, and streamlining government expenditure on social welfare schemes.

REITs and the real estate bill

Since the budget, the Securities Exchange Board of India (SEBI) has firmed up regulations that will govern REITs. Key features are as follows:

- Investment in completed and rent-generated assets should account for 80% of the value of REIT assets.
- REITs shall not invest in vacant or agricultural land or mortgages other than mortgage-backed securities.
- The minimum public holding in REITs should be 25%.
- REITs cannot accept a subscription amount of less than INR 200,000 from an applicant. The minimum issue size of the initial offer is INR 2.5bn, and the size of assets under REITs should not be less than INR 5bn.
- The sponsor of the trust will have to hold a minimum of 25% of the total units of the REIT after the initial offer for at least three years from the date of listing, followed by a minimum 15% stake thereafter. This requirement likely aims to avoid moral hazard related to securitisation.

Several tax-related issues still need to be resolved before REITs are launched in a meaningful way.

The revised real estate bill is due to be discussed in parliament during the winter session. The bill proposes to regulate transactions between buyers and promoters of residential real estate projects, aiming to increase transparency, make disclosure of project details mandatory, and provide a speedy complaint redressal mechanism via the establishment of a Real Estate Appellate Tribunal. It proposes to set up state-level Real Estate Regulatory Authorities (RERAs), whose main function will be to advise governments on the development of the sector, maintain and publish records on projects on its website, and conduct inquiries and penalise promoters if necessary.

According to the Union Urban Development Minister, the government may have difficulty getting the bill passed in the upper house of parliament given opposition from the Congress party. This could result in further amendments and delays to the bill.
Engaging more in the global economy

Though the government has not announced ‘big-bang’ reforms that would have pleased foreign investors, it has clearly indicated that it is keen to engage more closely and integrate itself further with the global economy. This includes a commitment in the budget to provide a stable policy framework for investment and to avoid retroactive changes to taxation. It also includes the liberalisation of FDI rules and a series of initiatives to improve the business climate. The ‘Make in India’ campaign aims to raise India’s international profile and promote it as an attractive destination for manufacturing. The Modi administration has also adopted a more proactive foreign policy in order to forge closer ties with strategic partners. This has included foreign visits by Modi to Bhutan and Nepal, Japan and the US. Leaders of South Asian Association of Regional Cooperation (SAARC) nations, the Australian prime minister, China’s president, and Vietnam’s prime minister have visited India. Modi has also met with BRICS leaders in Brazil, and will soon meet ASEAN leaders in Myanmar. The foreign minister has also been proactive in reaching out to various Asian economies. Several commitments and agreements have been made as a result of these visits.

- Japan has announced plans to invest USD 34bn (JPY 3.5tn) in India over the next five years (including public and private investment). India has reciprocated by proposing to set up a special management team under the PMO to facilitate investment proposals from Japan.

- China has committed investments worth USD 20bn in India over the next five years. Signalling the importance of the relationship, President Xi Jinping brought a delegation of 135 Chinese CEOs on his trip to India.

- The US-India Business Council (USIBC) has reportedly identified more than USD 41bn of planned investment by its members in India within the next three years.

Soon after the new government took office, Modi was instrumental in reaching an agreement on the formation of a BRICS bank, along with other BRICS leaders in Brazil. This Shanghai-based bank will have a rotating presidency (the first president will be Indian) and will fund infrastructure projects across member countries. BRICS leaders also agreed to set up a USD 100bn swap line as a contingent reserve agreement.

The focus on building India’s image in the international arena has been effective in improving investor confidence – FII inflows since the election have totalled USD 24bn, compared to an outflow of USD 9bn in the same period last year.

However, one sore point has been India’s opposition to approving the Trade Facilitation Agreement (TFA) under WTO negotiations. Investors have criticised India’s approach of making the TFA discussion contingent on an agreement on subsidies.
Areas where more action is needed

Our discussion so far has focused on areas where the NDA government’s reform initiatives have been in line with or exceeded our expectations. However, decision making has been slow in some areas, either because of unresolved issues between different political parties, or between the central government and the states, or misplaced priorities. If resolved, some of these issues have the potential to unleash substantial growth opportunities.

Land reforms

The previous administration replaced the archaic Land Acquisition Act with the Land Acquisition, Rehabilitation and Resettlement (LARR) Act 2013. However, industry associations have highlighted that the LARR Act is creating severe bottlenecks for land acquisition, often causing inordinate delays in the initiation of projects. There are two broad issues with the LARR Act: the compensation offered to landowners and the complex procedure of obtaining the necessary clearances.

The higher land prices offered under the act could be inflationary, and there appears to be little political will to change this. However, all state revenue ministers agreed in June on the need to change some of the procedures under the act, which have virtually halted the land acquisition process in India. The following features of the LARR Act need modification, in our view:

- Consent is required from a high proportion of land owners (70-80%, depending on the nature of the project).
- Compensation is paid to all 'affected' parties – not only the landowner, but everyone who was dependent on the land for their livelihood.
- The mandatory Social Impact Assessment (SIA) study for all projects appears to be an important cause of delays. Also, the acquirer has to go through multiple reviews involving local institutions before the acquisition process starts.
- The retrospective clause of the LARR Act has drawn criticism. The act requires that land has to be returned to the original owners if an acquisition has been pending for more than five years. After that, landowners are free to sell the land at the minimum stipulated price under LARR, which is much higher than what they received earlier. This provision can unfairly disadvantage land buyers, as the delay in land acquisition may be beyond their control.

The government is trying to amend some of these clauses, but since both houses of parliament need to pass the amendment bill, the government will need support from opposition parties in the upper house (which it does not control). Media reports indicate that the government might table an amendment bill in the winter session of parliament.

Uniform goods and services tax (GST)

GST implementation has remained elusive. In our view, the tax could lead to substantial productivity improvements, but there are still points of contention between the central and state governments. The government intends to introduce the Constitution Amendment bill to implement the GST in the winter session of parliament. However, it cannot be passed without support from opposition parties. Investors will be more confident in the government’s ability to push through big-bang reforms if the GST can be implemented on 1 April 2015 (the earliest date that it could happen); we note that the market is not optimistic about this timeline.
Manufacturing and job creation

Although Modi has urged global companies to participate in the ‘Make in India’ campaign, progress on creating a favourable business climate has often been slow. In particular, National Manufacturing and Investment Zones (NMIZs), which were intended to be centres of manufacturing activity, have not received enough attention. Skill development has been a constant theme of Modi’s speeches, but the strategy for large-scale job creation in the formal sector remains unclear.

Addressing medium-term food security

Improving the food supply chain by focusing on better storage and distribution should be a priority area of the NDA government. Progress on modifying the APMC Act (which forces farmers to sell their produce to government-appointed traders) has been slow, however. There has also been little progress on restructuring the Food Corporation of India (FCI), the sole body responsible for procuring, storing and distributing food grains through the public distribution system.

Banking-sector reforms

Improving the financial health of the banking sector is an unfinished agenda item for the new government. The RBI has taken some steps towards early recognition of NPAs and, according to media reports, the government plans to increase budgetary provisions for the recapitalisation of public-sector banks to INR 217bn from INR 112bn. Although these are steps in the right direction, more needs to be done. Our Equity Research team estimates that Indian public-sector banks will require INR 2.4tn of additional equity capital by FY19. The government needs to dilute its stakes in these banks substantially in order for them to meet this capital requirement.

The government is trying to overhaul the process of senior management appointments to public-sector banks to improve transparency, accountability and efficiency. The RBI is also preparing a framework to allow private players to set up different types of banks – not only the universal commercial bank but also smaller banks focused on specific areas of operation. These reform initiatives need to be followed up with robust actions.

Divestment

Progress on large divestment plans for FY15 has been slow. Almost no divestment of public-sector companies happened in the first seven months of the fiscal year, despite the government’s full-year target of more than INR 400bn of proceeds from such sales. It is still possible to meet the target if divestment efforts are stepped up now. If divestment falls short of expectations, meeting the fiscal deficit target will be difficult (83% of the FY15 deficit was reached in H1-FY15).
Conclusion

When the NDA government took power, investors hoped that it would usher in significant economic reforms. The pace of reforms has been mixed, and investor perceptions have swayed between disappointment and euphoria. The government has sustained the macro stabilisation process that began in September 2013, which involves reducing the fiscal and current account deficits, lowering inflation and stabilising the currency. However, it has not yet laid out detailed plans for manufacturing and infrastructure growth, which the market had expected.

The focus has been on micro-level policy changes to reduce bottlenecks and improve efficiency. These changes have taken place in several areas – reducing bureaucratic red tape, providing increased clarity on laws and regulations, introducing large-scale digitisation of government functions, and relaxing environmental and labour rules. We think these silent reforms are important in improving the ease of doing business in India. However, the economy still faces cyclical and structural headwinds, and the impact of these reforms on economic growth might be felt only with a lag.

The pace of reforms has picked up since the BJP won two state elections in October. The government has taken several steps to address bottlenecks in the energy sector and is likely preparing to introduce a series of measures in the winter session of parliament. In particular, we will be keenly watching progress on the GST, banking/financial services reforms, and changes to the land acquisition bill. The government is also trying to relax rules on FDI norms in sectors such as in defence, railways and construction to attract new foreign investors.

The policy action taken so far has been broadly in line with our expectations, and we are hopeful that macro reforms will continue until the budget announcement in February. Sustained reformist intent could keep asset markets buoyant and keep investors patient as they await a growth recovery.