Economy of India

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India's economic freedom score is 55.2, making its economy the 129th freest in the 2019 Index. Its overall score has increased by 0.7 point, with a strong increase in the score for judicial effectiveness outpacing a decline in monetary freedom. India is ranked 31st among 43 countries in the Asia–Pacific region, and its overall score is below the regional and world averages.

The government is expected to shift from efforts to improve the business climate to adoption of populist measures as the 2019 election approaches. India is developing into an open-market economy, but traces of its past autarkic policies remain. Economic liberalization measures that began in the early 1990s, including industrial deregulation, privatization of state-owned enterprises, and reduced controls on foreign trade and investment, have accelerated growth. Corruption, underdeveloped infrastructure, a restrictive and burdensome regulatory environment, and poor financial and budget management continue to undermine overall development.

Shifting Gears: Private Investment as the Key Driver of Growth, Jobs, Exports and Demand

During the last five years, India's economy has performed well. By opening up several pathways for trickle-down, the government has ensured that the benefits of growth and macroeconomic stability reach the bottom of the pyramid.

To achieve the objective of becoming a USD 5 trillion economy by 2024-25, as laid down by the Prime Minister, India needs to sustain a real GDP growth rate of 8%. International experience, especially from high-growth East Asian economies, suggests that such growth can only be sustained by a "virtuous cycle" of savings, investment and exports catalysed and supported by a favorable demographic phase.

Investment, especially private investment, is the "key driver" that drives demand, creates capacity, increases labor productivity, introduces new technology, allows creative destruction, and generates jobs. Exports must form an integral part of the growth model because higher savings preclude domestic consumption as the driver of final demand. Similarly, job creation is driven by this virtuous cycle.

While the claim is often made that investment displaces jobs, this remains true only when viewed within the silo of a specific activity. When examined across the entire value chain, capital investment fosters job creation as the production of capital goods, research & development and supply chains generate jobs. The Survey departs from traditional Anglo-Saxon thinking by advocating a growth model for India that views the economy as being either in a virtuous or a vicious cycle, and thus never in equilibrium. This model, in turn, stems from two key departures from the traditional view.

First, the Survey departs from the concept of equilibrium as a key tenet, which is being challenged increasingly following the Global Financial Crisis. Second, the traditional view often attempts to solve job creation, demand, exports, and economic growth as separate problems. As these macro-economic phenomena exhibit significant complementarities, the Survey postulates the centrality of the triggering macro-economic variable that catalyses the economy into a virtuous cycle. The Survey makes the case for investment as that key driver. By presenting data as a public good, emphasizing legal reform, ensuring policy consistency, and encouraging behavior change using principles of behavioral economics, the Survey aims to enable a self-sustaining virtuous cycle. Key ingredients include a focus on policies that nourish MSMEs to create more jobs and become more productive, reduce the cost of capital, and rationalize the risk-return trade-off for investments.

LAST FIVE YEARS: THE ACCOMPLISHMENTS Macroeconomic Stability

World output grew at 3.6 per cent in 2014 and again in 2018. In the intervening period, when the world did not appear to have changed much, India took a few giant strides forward. India became the sixth largest economy by sustaining growth rates higher than China; thereby earning the epaulette of being the fastest growing major economy in the world .Importantly, this pace of growth was sustained while re-establishing macro-economic stability.

Average inflation in these five years was less than half the inflation level of the preceding five years, matching the lowest levels attained in the country's post-independence history. The current account deficit (CAD) remained within manageable levels and foreign exchange reserves rose to all-time highs.

The performance was not just a onetime adjustment but stemmed from a new institutional framework. Following an agreement between Government of India (GOI) and Reserve Bank of India (RBI), a Monetary Policy Committee (MPC) was constituted in February, 2015 with the mandate to target a headline inflation of 4 per cent, with a band of two percentage points on either side. The framework has been successful in containing inflation. Since April 2015, when the MPC was first convened, the monthly headline inflation has always remained within the band except for one month.

Discipline was also imposed on the Gross Fiscal Deficit (GFD). The Fiscal Responsibility and Budget Management (FRBM) Act of 2003, which got a new lease of life since 2016, determines the glide path for the ratio of GFD to GDP to reach an eventual target of 3 per cent. The ratio declined from 4.5 per cent in 2013-14 to 3.4 per cent in 2018-19. Other macro-stability indicators have similarly improved.

Infrastructure

The creation of physical infrastructure accelerated significantly during 2014-19. In April 2018, electricity finally reached every village in India with the effort to electrify every home still ongoing. The construction of national highways (NH) proceeded at a rapid pace with more than 20 per cent of the existing highway length of 132,000 km being constructed in the last four years alone. The UDAAN scheme was launched in 2017 to foster regional connectivity by extending flight connectivity to Tier-3 and Tier-4 towns in the country.

Over 30 unserved and underserved airports have been mainstreamed under UDAAN with flights creating additional 40 lakh seating capacity. The scheme has also sparked significant increase in helicopter services in hilly areas and islands that engage 31 heliports. The infrastructure of the Northeastern states was a special focus and there has been a significant improvement in connectivity with the building of key bridges, and the expansion of railways/highways. The 4.94 km long Bogibeel Bridge in Assam was inaugurated in December 2018; it is the second longest rail-cum-road bridge in Asia.

Federalism

Fiscal federalism strengthened significantly when the Fourteenth Finance Commission increased the share of states in the divisible pool of central taxes from 32 per cent to 42 per cent. Although central grants to states saw compensatory cuts, the shift empowers states to manage their revenues and expenditures independently. The launch of the GST (Goods and Services Tax) in July 2017 added a new dimension to center-state and inter-state financial relations. The GST Council experience provides key learning for implementing cooperative federalism in several other areas such as labor and land regulation. Niti Aayog has helped institutionalize cooperative federalism by setting up teams from both the states and the central government to jointly evolve strategies for addressing development challenges. States have also been involved in a friendly competition to improve their Key Performance Indicators (KPIs).

Corporate Exits

When the Insolvency and Bankruptcy Code (IBC) was introduced in 2016, it consolidated the insolvency resolution process into a single law by repealing/ amending multiple rules and processes earlier in operation. IBC set a time limit for closing of insolvency and bankruptcy cases within which assets of a defaulting borrower are auctioned to pay off the debt owed to lending institutions. Following the operationalization of IBC since 2017, a significant number of non-performing assets have been brought under its ambit. In addition to the large sums recovered by creditors from resolution or liquidation, the introduction of a framework for exit has improved the overall business culture of the country.

THE NEXT FIVE YEARS: A BLUEPRINT FOR GROWTH AND JOBS

With the micro-economic and macroeconomic foundations laid over the last five years, the Indian economy is ready to shift gears so that economic growth, jobs and exports can be pushed up to the next level. For this purpose, the Survey presents a blueprint.

Emphasizing Growth

As articulated by the Prime Minister, Shri. Narendra Modi, India aims to grow into a USD 5 trillion economy by 2024-25, which will make India the third-largest economy in the world.

Given 4% inflation, as the Monetary Policy Framework specified by the Government for the Reserve Bank of India, this requires real annual growth rate in GDP of 8 per cent.1 What are the ingredients of a model that can generate such growth?

To understand this key question, we examine the drivers of economic growth followed by countries across the globe. In recent times, Chinese economic growth stands out for its explosive growth over a long period of four decades. Post war economic expansion in Western Europe led to high growth rates of its economies. During 1950-73, Japan's GDP growth rate frequently exceeded 10 per cent. Post World War II, Hong Kong, Singapore, South Korea, and Taiwan successfully maintained a rapid growth rate of more than 7 per cent until 1980s.

Exports

With the share of consumption in GDP constrained by the high level of savings, domestic consumption can be, at best, act as strong correlation between growth in exports and GDP growth for the high growth East Asian economies. 1.29 The global market is extremely competitive with the firms that are able to produce at the lowest costs having the ability to gain market share in exports. So, average productivity of firms in the economy becomes crucial to export competitiveness. As seen in Figure 11, capital investment enhances total factor productivity, which in turn enhances export performance. Therefore, investment becomes crucial to enhancing export performance. 1.30 While it is true that world trade is currently facing some disruptions, India's share in global exports is so low that it should focus on market share. One could even argue that the current disruptions provide an opportunity for India to insert itself into global supply chains. The High Level Advisory Group, chaired by Dr

Surjit Bhalla, submitted its report in June 2019 on how India can enhance its exports. Its recommendations need to be studied and implemented where possible.

The tax structure in India is divided into direct and indirect taxes.

While direct taxes are levied on taxable income earned by individuals and corporate entities, the burden to deposit taxes is on the assesses themselves. On the other hand, indirect taxes are levied on the sale and provision of goods and services respectively and the burden to collect and deposit taxes is on the sellers instead of the assesses directly.

Taxes in India are levied by the Central Government and the State Governments. Some minor taxes are also levied by the local authorities such as the Municipality and the Local Governments.

Over the last few years, the Central and many State Governments have undertaken various policy reforms and process simplification towards great predictability, fairness and automation. This has consequently lead to India's meteoric rise to the top 100 in the World Bank's Ease of Doing Business (EoDB) ranking in 2018. The Goods & Services Tax (GST) reform is one such reform to ease the complex multiple indirect tax regime in India.

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