



Reforms to Push Growth on High Road

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PHD RESEARCH BUREAU

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Sandip Somany
President

Foreword

The economic history of India dates back to the inception of the Indus Valley Civilization which marked an era of economic prosperity for the country. However, the arrival of the East India Company and the subsequent colonization of the economy by the British dampened its growth prospects significantly.

During the post-Independence period and the period of the “Five-year plans” efforts were focused on identifying the needs of the economy to take off again. Further, the economic reforms in early 90s opened a new chapter in India’s economic history. It gave India an opportunity to shake off the shackles of its past and emerge on the world stage as a progressive nation.

The reforms era brought in a spurt of structural changes in the economic policy of the country such as removal of barriers and de-licensing in industries, removal of financial sector controls, rationalization of tax structure, opening up to foreign investors and reduction in tariff barriers.

Today India is on the steady growth path. However, the current global economic crisis and its contagion on the emerging markets like India have the potential of posing a threat to its growth story. At this juncture, the country looks forward to the new set of economic reforms which encompasses core sectors of the economy, inducing productive investments and reviving the growth momentum of the country, going forward.

The study puts together a road map for economic reforms in the country which could go a long way in its economic progress. I am hopeful that it would serve as a guide for the policy makers and help in further policy formulation.

Sandip Somany



Susmita Shekhar
Secretary General

Preface

'Reforms to Push Growth on High Road' has been prepared with the objective to put forth the PHD Chamber's vision on unveiling the new set of economic reforms in India so as to bring it back in the high growth track and it gives me immense pleasure and honour to present it to our esteemed readers.

It is a report on the present state of the Indian economy and potential areas of growth. It also highlights the need for reforms in the country and the areas which require immediate policy intervention.

We at the PHD chamber feel that structural reforms are a must if growth has to pick up and if double-digit growth is ever to materialise, going forward. Further, the strategy should not focus to achieve higher growth for just one or two years, but should talk about ushering growth at a faster pace on a sustained basis.

I commend and appreciate the efforts of PHD Research Bureau which has come up with this report with its focused approach. I hope that this study will add to the research being done on this subject and enhance the horizons for policy formulations in India.

Susmita Shekhar

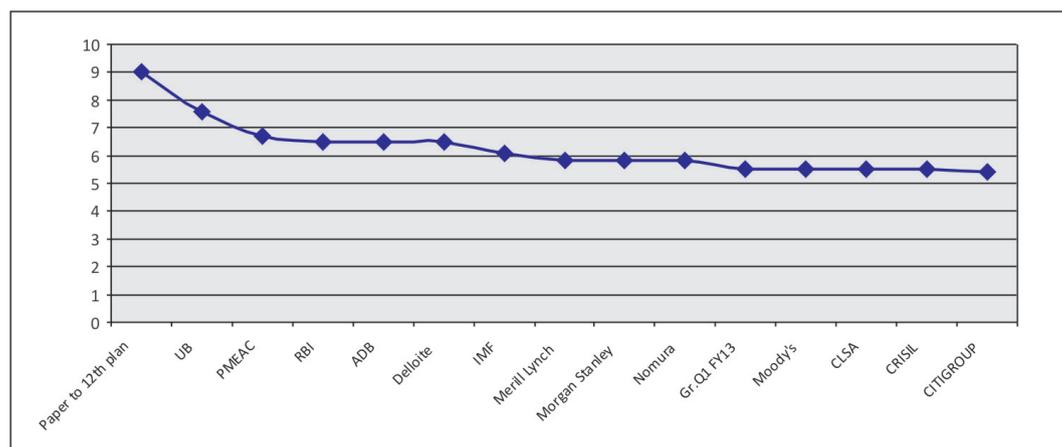
1. An overview of current economic situation

With the onset of the sovereign debt crisis in the Euro-Zone, and with the consequent spreading of the contagion across the advanced and now the emerging economies, the risks to India's growth have risen significantly. Although, India's growth remains one of the highest in the world, but a range of factors have weighed it down. It is worrying to note that the economy has slowed more than most other major emerging economies as concerns over governance and policy uncertainty have dampened investments.

IMF has also reduced the global growth forecast to moderate at 3.5% in 2012 and 3.9% in 2013 whereas the growth in advanced economies is expected to remain very sluggish at 1.4% during 2012 and 1.9% during 2013. According to IMF forecasts, India's growth outlook stands at 6.1% for 2012 and 6.5% for 2013, while emerging and developing economies are expected to grow by average rate of 5.6% during 2012 and 5.9% during 2013. On the other hand, developing Asia's average growth is estimated at 7.1% for 2012 and 7.5% for 2013.

Presently, the domestic scenario has witnessed deceleration in almost all the lead economic indicators. The growth of real GDP has been impacted significantly in the recent times. The real GDP growth decelerated to 6.5% during FY 2012 as compared with 8.5% in FY 2011 and 8% in FY 2010 while Q1 FY2013 real GDP growth stood at 5.5%. Recently, many apex bodies have lowered India's growth forecasts on account of the weakening growth prospects. While the Prime Minister's Economic Advisory Council has estimated growth of 6.7%, RBI has revised downward the growth projection for 2012-13 to 6.5%. The credit rating agencies like Moody's and CRISIL have estimated it to be around 5.5%. The recent move by the Fitch to revise India's Outlook to BBB- has further raised concerns amongst investors on the country's growth prospects.

The growth projections so far...



Source: PHD Research Bureau, compiled from various sources

The agriculture sector in India is at a crossroads with rising demand for food items and relatively slower supply response in many commodities resulting in frequent spikes in food inflation. The green breakthrough achieved in the 1970s, and 1980s is gradually disappearing. Since 1990, agricultural sector

experienced poor performance and has become major cause of concern for food security, rural poverty and unprecedented rise in prices. The sector's contribution in GDP has been decelerated to around 14% during the recent years from around 18% in the high growth period (FY05-FY08). Further, the growth of agriculture sector has sharply decelerated from 6.6% in FY2011 to 2.8% in FY2012. In addition, the current deficit in the South-West monsoon has impacted the agricultural growth prospects. The seasonal rainfall during this year's monsoon for the country as a whole has been 8% below the normal from 1st June 2012 to 13th September 2012.

Inflation has been a major challenge creating a road block to India's growth story. Average inflation remained steep at 7% during FY2010-12 as compared with 6.4% during FY 2007-09 and 5.5% during 2004-06. Although, in recent months, the inflation has moderated to the much expected level of 7-8% from the 10-11% trajectory, sequential growth pattern indicate that the inflation is going to remain sticky at this level in the coming months.

The interest rates have been on the higher trajectory with the repo-rate being raised significantly over the quarters from 5.75% in September 2010 to 8.25% in September 2011 and to 8.50% in October 2011, mainly in a bid to tackle the inflationary pressures in the economy. Although, the rate has been marginally sliced to 8% during April 2012, it still soars high making borrowing dearer for the industrialists. This has hit the investors' sentiments in the economy, creating a dent in investments in recent times.

The large improvement in gross domestic savings from 26.5% of GDP in FY 2002 to 37% during FY 2008 was a great achievement. However, the rising fiscal stress and price rise has impacted the momentum in recent years. The gross domestic savings as a percentage of GDP has slipped from around 37% during 2007-08 to the post Lehman crisis phase, when the savings rate has hovered around 32-33% of GDP during 2008-09 to 2011-12.

The investment situation in India is turning from bad to worse. The difficulty of forecasting returns in a highly volatile economic environment, governance concerns, heightened global uncertainty, rising funding costs and structural rigidities have all played a part. Gross domestic capital formation as a percentage of GDP has been stagnating year after year. The ratio stands at 35% in 2011-12 as against 38% in 2007-08.

The slowing of industrial output from an average of 8.3% in FY2011 to 3% in FY2012 and -0.1% during April-July FY2013 is raising concerns. The manufacturing growth stands at a disappointing -0.6% while the growth in capital goods is as low as -16.8% during April-July FY2013. The consumer goods segment has tracked a modest 3.3% growth during April-July FY2013.

The growth in services sector has been vibrant over the past many years, contributing sizably to India's steady growth story. However the recent slowdown in the sector from around 10% in FY2010 to 9.4% in FY2011 to 8.8% in FY 012 (7.7% in Q1 FY2013) is a cause of concern. India's exports growth has dropped from around 40% in FY2011 to around 20% in FY2012 and to -5.9% April-August FY2013. The CAD has significantly widened from 3.8% of GDP during Q1FY12 to 4.5% of GDP during Q4FY12.

The rising global risk aversion has reduced the flow of capital. The FDI investments have been impacted significantly which is indicated from the sharp de-growth in FDI by -41% during April FY2013 as compared

to a robust growth of 88% during FY 2012. The portfolio investments also, in terms of FIIs have shown a volatile trend causing instability in the domestic stock markets.

The exchange rate volatility has also risen significantly with the onset of world economic slowdown, with the rupee depreciating the most among the major Asian economies. The sharp decline of the rupee from Rs.45.5/US\$ in FY 2011 to Rs.47.6/US\$ in FY 2012 to Rs.55.3/US\$ during August FY 2013 is alarming. On the other hand concerns about global growth have impacted investors' sentiments and de-leveraging by many advanced economies has raised the cost of external finance.

The fiscal situation has also been worrisome, worsening throughout FY2012. Notwithstanding improvements of India's fiscal position during FY2011, concerns about fiscal slippage have emerged since the beginning of FY2012 on account of sizeable upside risks to subsidies and downside risks to revenues from moderation in growth. The gross fiscal deficit as a percentage to GDP is likely to shoot up significantly, as compared to the anticipated level of 5.1% in FY2013. The mounting subsidy burden of the government has dampened the fiscal health of the economy. The subsidy burden of the government is estimated to creep up to around 2% of the GDP during FY 2012-13. Since India imports 84% of its crude oil demand and heavily subsidises domestic consumption, high prices have resulted in a widening deficit not just in foreign trade scenario, but also for the fiscal health.

Increase in price of Diesel by Rs. 5 per litre and restricting the supply of subsidized LPG cylinders to each consumer to 6 cylinders (of 14.2 Kg) per annum, however, these decisions will reduce the under-recovery of oil marketing companies (OMCs) by about Rs. 20,300 crore and the under-recovery for 2012-13 will be about Rs. 1,67,000 crore which is more than the under-recovery of Rs. 1,38,541 crore incurred by OMCs during 2011-12.

The Indian economy so far....

Components	FY2010	FY2011	FY2012	FY2013
Real GDP Growth	8	8.5	6.5	6.7#
Agriculture Growth	0.4	6.6	2.8	0.5#
Industry Growth	8.3	7.8	3.8	5.7#
Services Growth	10.1	9.4	8.8	8.9#
Inflation- WPI	3.6	8.6	8.2	6-7^
Inflation- CPI	13	9.5	8.4	NA
Fiscal Deficit as a % of GDP	6.5	5.2	5.9	5.1~
Subsidies as a % of GDP	2.10	1.71	2.43	1.87~
Gross Domestic Savings as a % of GDP	33.8	32.3	33.0	NA
Gross investments as a % of GDP	36.3	34	34	33.4^^
FDI equity inflows (US\$ bn)	25.96	19.42	23.50*	4.4<
FII inflows (US\$ bn)	30.09	32.13	19.67	NA
Foreign Exchange reserves (US\$ bn)	279.1	304.8	294.9	289.2**
Exports Growth %	-3.53	40.49	20.94	(-)5.9**
CAD as a % of GDP	(-)2.8	(-)2.6	(-)4^^	NA
Rupee exchange rate (yearly avg)	47.41	45.57	47.65	54.17@

Source: PHD Research Bureau, compiled from various sources,

Note: # PMEAC estimates ^ PHD Chamber estimates ~Data represents Budget estimates ^^ Average upto Q3FY12, * Data pertains from April- December, <Data for Apr-June 2012, **Data for Apr-August 2012, ## Data represents April 2012 yoy growth, @Data as on 21st August 2012

2. Policy inertia impacts corporate profitability

The April-June FY 2013 revenues of India's top companies grew at the slowest pace in three years and net profits increased by a meager 0.5% as the rising interest rates and input costs and a slowdown in investments squeezed profitability. It is significantly low as compared to the growth of 6.4% a year ago or during the April-June FY 2012.

An analysis¹ of the quarterly results of over 1,400 companies, excluding firms in banking, finance and petroleum, shows that revenues expanded by 14.3%, which was the lowest in the last nine quarters. What is worrying is that at a time of weak top line or revenue expansion, interest and input costs continue to spiral, reflecting the inability of companies to pass on the cost burden to end-users. The cost of raw material relative to sales continued to increase even though commodity prices cooled off globally in the past six months. The proportion of raw material costs to net sales jumped to a nine-quarter high of 36.6% from 35.5% a year ago while the share of interest expense in sales topped 3.6% for the first time since June 2009, when it stood at 2.7%. Interest costs shot up by 42.6% year-on-year in the April-June FY 2013, marking the fourth successive quarter in which interest outgo rose by more than 40%.

2.1 Falling capex signals stagnation, going forward

Leading indicators such as trend in capital expenditure and credit off take by the industry suggest that the performance of Indian companies will remain muted in the next few quarters. According to latest data², capacity expansion for new and existing projects fell by 11% in FY 2012 even though overall investments in the economy grew by nearly 5%. What should be alarming this time around is the sharp decline in the expenditure on existing projects. Capacity expansion on new projects has been falling for the past three years, capital expenditure on existing projects dropped by 46% in FY 2012. A falling capex cycle signals an extended period of stagnation in the economy, going forward.

2.2 Costs of doing business in India

India has been placed at 132nd position in Doing Business Index 2012 by World Bank and International Finance Corporation (IFC), up from 139th position in previous year Doing Business Index 2011. India stands at 166 in the ranking of 183 economies on the ease of starting a business in 2012. These rankings indicate that India could do more to enhance corporate sector profitability by reducing the costs of doing business and improving institutions.

The ease of starting business in India over time

Indicator	DB'07	DB'08	DB'09	DB'10	DB'11	DB'12
Ease of Doing Business (Rank)	134	120	122	133	134	132
Starting a Business (Rank)	88	111	121	169	165	166
Procedures (No)	11	13	13	13	12	12
Time (Days)	35	33	30	30	29	29
Cost (% of per-cap income)	73.7	74.6	70.1	66.1	56.5	46.8

Source: PHD Research Bureau, compiled from Doing Business in India 2012 by World Bank and IFC.

3. Why India needs new set of economic reforms

The economy has done very well on the growth front, when viewed in a long term perspective. India's GDP growth rate averaged only 3.5% per year in the 1960s and 1970s, at a time when other developing countries were growing much faster. The 1980s saw the beginning of a reorientation of policies to achieve higher growth and indeed growth accelerated to 5.6% in that decade. Further, the era of reforms in the 1990s opened up avenues of delicense, decontrol, trade and financial liberalization, tax reforms and facilitation to foreign investments. It marked a major break-through in India's rapid progress.

India's performance improved significantly in the 2000s, spurred by favourable global conditions and the cumulative effect of the systemic reforms initiated in 1991. The 2000s achieved an average real GDP growth rate of 7.3% (at factor costs constant 2004-05 prices). The decade of 2000s also saw a high annual average GDP growth of about 9% for the five year period 2004-08. Growth in all the sub-sectors of the economy, including agriculture, accelerated during this period.

India's real per capita income, which had taken four decades to double by 1991, doubled thereafter in 15 years and is likely to double again in 10 years. The recent trend in growth of nominal per-capita income is also very inspiring as it grew steady from Rs33394 in FY2006 to Rs55191 in FY2010 and Rs73676 in FY2012 marking an increase of about 121% during FY2006-12. Moreover, the Indian economy has been among the fastest growing in the world in recent years, even in the last fiscal year when growth slowed to a multi-year low of 6.5%.

Over the period 2000-11, India's share in world GDP rose from 1.5 per cent to 2.4 per cent in terms of US dollar, and from 3.8 per cent to 5.7 per cent in terms of PPP. This improved economic performance dramatically altered global perceptions of growth prospects of Indian economy. An early recognition of this was a Goldman Sachs report (November 2002), which included India, with Brazil, Russia and China in a new BRICs group of emerging market countries which was predicted to overtake the G-8 in terms of total GDP by 2035.

3.1 Post-Crisis growth performance

The onset of global financial crisis in 2008 interrupted India's growth trajectory. Despite being located far away from the epicentre of the crisis, India could not remain insulated from the adverse impact of the crisis. The knock-on impact of the global financial crisis was felt through all the channels - finance, real and more importantly, the confidence channel. Initially the impact was visible on India's financial markets – equity prices fell reflecting withdrawal of global investment, currency depreciated reflecting global risk aversion, and money and credit markets came under pressures with substitution of external sources of funding with domestic sources. Reflecting greater global integration, the Indian trade and business cycles had also become increasingly synchronised with global cycles. Consequently, the adverse

¹ The ET Intelligence Group, *The Economic Times*, August 13, 2012

² RBI

impact of external demand shocks was manifested in terms of a moderation in Indian economic growth from 9.3% in 2007-08 to 6.7% in 2008-09. Following expansionary monetary and fiscal policy response, growth recovered quickly during 2009-10 and 2010-11, before slumping again to 6.5% in 2011-12. GDP growth is expected to be around 6% in 2012-13 also.

Despite the predominant domestic nature of India's growth story, volatility in growth has brought to the fore the debate on the potential rate of growth and the role of macroeconomic policies in stabilising growth around the potential rate of growth. Analysis of the sectoral composition of growth reveals that the growth moderation during 2008-12 has been driven largely by manufacturing and agriculture sectors. On the expenditure side, growth was led by both private and government consumption expenditure as investment growth moderated. Productivity growth has slackened as reflected in increase in ICOR to 4.8 from 3.9 in the pre-crisis period. Domestic savings rate has moderated driven by significant fall in public sector savings rates as government revenue deficit increased. More worrying has been a sharp deterioration in household's savings rates in financial assets.

3.2 Emergence of new policy challenges

The global situation is much worse than it was at the earlier years of Post-Lehman crisis. Global growth is likely to slow down further. US growth is decelerating, the European crisis appears to be deepening, although Europe has shown commitment to the Union, and there is increasing evidence of emerging markets growth slowdown.

On domestic macroeconomic concerns, the current situation is by far the most difficult, in the last several years. Infrastructural bottlenecks in power, coal, and transport seem to have worsened, causing serious supply side pressures. With weaknesses in power and aviation sectors, public-private-partnership projects are getting impacted, which entails the risk of lowering private investment in infrastructure. The manufacturing sector is at a standstill, with not only the capital goods industry in a bad shape, but also the short-cycle consumer products registering a contraction.

Wage pressures remain significant, particularly in rural areas. Moreover, structural problems, such as those in proteins items, are keeping non-core inflation high. Additionally, inflation concerns stem from suppressed inflation and tightening supply bottlenecks in infrastructure. The economy is in a bind with slackening growth and elevated inflation.

There could be a slippage in the fiscal deficit in 2012-13. External sector concerns had also increased considerably. FDI has slowed down while the current account deficit (CAD) remains high, although there was some improvement in the last quarter as international oil prices and gold imports fell.

3.3 Reforms critical to sustain high-growth trajectory

Looking ahead, India will continue to deliver strong growth, supported by rising income levels and favourable demographics. However, the country has potential to grow even faster, but this requires

further structural reforms and accelerated implementation. Structural reforms are a must if growth is going to pick up and if double-digit growth is ever to materialise, going forward. In the recent years, reform implementation has slowed down significantly, which has led to a supply-driven slowdown in growth. With supply struggling to keep pace with demand, inflation has remained persistently high despite the slowdown in growth. In the absence of accelerated pace of structural reforms, It will be very difficult to sustain high growth trajectory without seeing a build up of inflationary pressures. Moreover, the growth strategy should not focus to achieve higher growth for just one or two years but it should be talking about being able to grow at a faster pace on a sustained basis.

3.3.1 Economic reforms so far

India's economic success since the 1980s has gone hand in hand with important economic reforms. Key among these was steps to liberalise the industry and service sectors, gradually open up for foreign trade and investment and improve the fiscal position. The New Industrial Policy promoted competition by abolition of monopoly practices, termination of phased manufacturing programmes, freeing foreign direct investment, allowing import of foreign technology and reducing sectors reserved for the public sector.

Infrastructure sector was opened to the private sector. The public private partnership (PPP) was given emphasis as a preferred mode for implementation of infrastructure projects. Apart from 100% FDI allowed in the infrastructure sector, various tax holidays were also given to enterprises engaged in the business of development, operation, and maintenance of infrastructure facilities.

Reforms in the financial sector provided greater financial autonomy to banks and other financial institutions. Major reforms in the financial sector were reduction in statutory pre-emption's, deregulation of interest rates, allowing entry of private banks, dilution of government holding in public sector banks and institution of prudential norms to strengthen the working of banking system. The most important development in the monetary policy framework was the abolition of automatic monetization of fiscal deficit from April 1997, which provided instrument independence to the Reserve Bank of India in the conduct of monetary policy. The external reforms gave way to a shift from the administered exchange rate regime to a flexible exchange rate system. Trade policy reforms comprised withdrawal of quantitative restrictions on export and import, elimination of import licenses and lowering of nominal tariffs.

The liberalization of restrictions on various external transactions led to current account convertibility under Article VIII of the Articles of Agreement of the IMF in 1994. With respect to capital account liberalization, India commenced with a gradual and well sequenced opening up of the capital account.

4. New phase of economic reforms

With the emergence of multiple policy challenges due to intensification of global and domestic economic problems, the Indian economy is caught up in a downward spiral. Unless some quick action is taken, the slowdown may continue or even get worse because global slump is not showing any signs of revival. The

focus should be to reduce the subsidy bill, fast-track FDI policies and disinvestment as well as consider giving temporary incentives to industry for capacity addition and job creation. Speedy implementation of the GST, reduction of minimum alternate tax for SEZs and dilution of the proposed land acquisition bill should be ensured.

The PHD Chamber welcomes the recent big-bang reforms undertaken by the government. These reforms will push India's real GDP to high growth trajectory in the coming years. FDI in multi-brand retail is seen as a very important reform to revive the economy and it will ease supply side pressures and mitigate inflation and benefit, especially, the small and medium enterprises by way of greater market access and higher profit margins. 49% FDI in the aviation sector with the view of the ongoing crisis in the aviation sector is also a welcome move. The entry of foreign players will not only bring funds but expertise as well. The recent reform to subside the staggering subsidy burden of the government by hiking diesel prices by Rs5/liter could go a long way in improving the fiscal health of the economy. We appreciate the progress made in the financial front, notably the liberalisation of savings deposit rates, continued opening of domestic debt market to foreign investors and FDI in single brand retail. However, important reforms like implementation of tax reforms like GST and DTC, infrastructure development fund, swift clearances in land acquisition and environmental issues etc, are still awaited.

Against this backdrop the PHD Chamber looks forward to rapid economic reforms in the country, which prioritises on stabilizing the macro-economic environment to retain the confidence in not only the investors but also various other segments whose sentiments are impacted by volatility in economic system.

4.2 Arrest inflation to resume macro-economic balances

Inflation has been posing a major challenge to India's growth story. Inflationary pressure is attributed mainly to rise in global prices of crude oil, food-grains and metals, domestic supply constraints in the food economy and overheating caused by fiscal imbalances across the world. Despite various measures undertaken by RBI through its tight monetary stance, WPI inflation still remains in an uncomfortable trajectory. The WPI inflation for the month of August is estimated at 7.5%. Consumer price index which weighs food heavily has been above 7%, for almost four years. It still hovers around 10% for the month of July 2012.

With rise in incomes across rural and urban areas, consumers have been found to spend more on high value and better quality food items; consequently altering the composition of food demand. Hence the shift in consumption pattern and rising demand supply mismatch in food economy have all played their part in fuelling up food prices. Large increases in agricultural support prices and indexation of rural wages have also contributed to stoke inflation.

High food inflation is worrisome for people and policymakers and is like a hidden tax on the poor who spend 60% of their income on food. High levels of prices, especially vegetables, fruits, milk; eggs etc have been reflected in double digit rates of inflation. Since these commodities are perishable in nature and

need fast moving and efficient supply lines, there is a requirement for massive investment in logistics that can connect the agri-processors, retailers and exporters and hence help in closing the demand-supply gap.

4.2.1 Agriculture reforms to tackle food inflation

Our agriculture sector is at the crossroads with rising demand for food items and relatively slower supply response in many commodities resulting in frequent spikes in food inflation. Since 1990, agricultural sector experienced poor performance in terms of stagnating productivity and has become major cause of concern for food security and rural poverty. The government spending on rural infrastructure is inadequate while about 75% of government allocation on agriculture is applied for subsidies only. Government spending should target on enhancing public investments in developing agriculture infrastructure to make urban market approachable to farmers. The central plan outlay for the agriculture sector is only 2-3% of the total central plan outlay during the last three years. It should be enhanced to at least to 5-6% of the total planned outlay.

Even though production of vegetables and fruits have increased in recent years, however, around 40% of it goes into the waste between the farm gate and the market because of poor supply infrastructure. The APMC act which deals with marketing of farm produce directly from farmers is inhibiting smooth distribution of farm output. Some states have modified it, but many do not allow retailers to buy directly from farmers. It is necessary to provide incentives to states to abolish the APMC act within a year.

There is a need to increase agricultural productivity and improve supply elasticities. Without adequate agricultural supplies, inflation management is going to be a difficult task, given the transition of a significant part of the population into the consumption stream. The policy should focus raising agricultural productivity and diversify agriculture to feed large population. A large part of the workforce will have to be withdrawn from the agriculture sector to improve productivity of the overall economy.

At this juncture, rapid farm sector reforms are necessary not only for the fact that about 53% population is still dependent on this sector but also to tackle food inflation vis-à-vis remove output gaps and to sustain higher economic growth. Concerted and focused efforts are required for addressing the challenge of stagnating productivity and disrupted delivery in agro output. Critical steps to push agriculture reforms are as follows:

- a) **Minimise the wastages** by augmenting storage capacities, modernizing/ upgrading the godowns.
- b) **Increase public investments** in agriculture sector to improve agriculture infrastructure from farm gate to agricultural markets.
- c) **Strengthen the role of agricultural universities** and to monitor the usage of the sanctioned amount.
- d) **Technology to improve the yield/productivity** along with expanded irrigation facilities and fertilizer availability.
- e) **Ensure credit availability to small & marginal farmers** to adopt modern farm techniques.
- f) **Remove hurdles in the marketing** of produce such as octroi and mandi taxes.

4.2.2 FDI in retail to remove supply side bottlenecks

FDI in multi-brand retail is seen as a very important reform to revive the economy and the recent move to allow 51% FDI in multi-brand retail is set to drive India's growth to the higher trajectory. India has a weak supply chain and burgeoning demand. The income of the rural sector is rising and hence the demand. To mitigate the demand-supply gap, reforms in the multi-brand retail are essential.

Economy faces supply side constraints not only because of the lower production of farm output, but also because of the delivery of farm output from farm gate to consumers which involves several mediators and price of that product inflates because of cascading impact of higher profit margin at each stage. The provision to allow foreign retailers to hold 51% stake in the multi-brand retail sector along with the enhanced cap on the single brand segment to 100% would help in reducing post-harvest losses and minimizing wastage. These would provide state of the art infrastructure right from post-harvest, farm gate linkages, packaging and cold storages.

FDI in retail sector will address the supply side constraints, lower inflation expectations and benefit, especially, the small and medium enterprises by way of greater market access and higher profit margins. Allowing FDI in retail would have the potential benefits:

- a) **Efficient use of farm output** -- The retailers have massive infrastructural set up which provide for better storage and preservation of perishables. It would facilitate in building up back-end infrastructure such as cold chains and warehousing which could in turn help in efficient use of farm product.
- b) **Lower costs vis-à-vis large scale economies** -- FDI in retail sector could lower costs and increase efficiency because of large scale economics. Small production units are not able to sell their products in the high demand segments because of lack of accessibility and high transaction costs. This will link the micro and small enterprises with the larger markets, boosting the sentiment for more production.
- c) **Quality standards** -- Super-market chains would lead to better safety and quality standards by providing immense potential for product diversification and export enhancement of agriculture produce.
- d) **Benefiting farmers vis-à-vis direct procurement** -- Retail chains will procure directly from the farmers, providing them much higher prices for their produce as compared to the present situation where a number of middle men are engaged in the process, who make profits at every stage of distribution.

4.3 Induce investments to kick start growth

While investment was the main driver of growth before the global financial crisis, it has been lacklustre since then. With FDIs stagnating and the FIIs unstable, the slowdown in investments is also clear from the fact the corporate investment has slipped to 10% of GDP in the post Lehman crisis period from 14% before the crisis period. Both macro-economic and structural factors are responsible for the recent weakening of corporate investments. These have to be addressed, and the government has to send positive signals to the investors. The time is most opportune to provide better policy environment that will reassure investors' confidence and nudge entrepreneurs to invest. The following measures could bring back the investment momentum in the economy:

- a) The delays and controversies pertaining to acquisition of land have delayed projects in power, mining, auto and other sectors. A clear equitable and transparent policy may help avoid such lags. These issues should be addressed and expedited.
- b) The focus should be on employment enhancing strategies. Investment allowances should be re-introduced on investments of Rs.100crore / Rs.250 crore / Rs.500 crore or employment of additional 100 people / 250 people / 500 people. This window should be given till 31st March 2016.
- c) Monetary policy needs to focus on containing inflation and anchoring inflation expectations; however, this is essential to usher in a low interest rate environment which is crucial for raising the overall investment.
- d) Raising FDI Limits in various sectors and opening up of 51% FDI in retail and aviation sector is a very welcome move. 49% FDI in the aviation sector with the view of the ongoing crisis in the aviation sector is appreciable. The entry of foreign players will not only bring funds but expertise as well. Raising FDI in insurance may also be encouraged, going forward.
- e) While big moves like opening up of FDI in more sectors will create an environment that is conducive to foreign investment, India also needs several improvements like easier visa and immigration rules, faster permission on issues related to transport, etc.
- f) Financial sector investments need to be made more lucrative so that the household investments in physical assets like gold/ land may be diverted to productive capital formation.

4.3.1 Divert household physical savings toward financial savings

Lower household financial saving as observed over the last two years can pose a resource constraint for growth in coming years. It could be due to several factors, viz., entrenchment of household consumption levels, persistently high inflation and consequent lower real return on financial assets, and increasing popularity of gold as an investment option. Therefore, control of inflation and improving the real return on financial assets become important so that growth prospects do not suffer due to inadequate supply of domestic saving.

4.3.2 Improve economic competitiveness

Current account deficit, recorded at historically high of 4.2 per cent in 2011-12 is not only unsustainable but also does not augur well for growth potential of the economy. Increasing vulnerability of India's external sector can deter confidence of global investors and impair financial flows required to meet the domestic saving-investment gap. Therefore, there is a need to improve competitiveness of the domestic economy while ensuring that the policy environment remains conducive for investment. In this context, price stability is also important for exchange rate stability.

4.4 Promote exports to address external vulnerability

We appreciate the Government's efforts for maintaining steady growth momentum of India's exports scenario. India's exports grew fastest in the world, recorded a growth of 16% in 2011, even as the global trade expansion slowed to 5%. We believe India is a success story in terms of diversification of export and

import markets. The share of Asia and ASEAN in total trade increased from 33% in FY2001 to 57% during the FY2012, while that of Europe and America fell from 42% to 31% respectively.

In fact, in recent years, due to export diversification efforts, the share of developing economies in India's total exports witnessed a gradual increase. However, we are not yet out of the woods, the WTO forecasts indicate further slowing down of world trade in 2012 to 3.7% as the downside risks remain high. The sluggish economic conditions in advanced economies may slowly spill over to other emerging and developing economies and hence diversification may not yield results similar to those seen in previous years.

Measures announced in the annual supplement to the Foreign Trade Policy (2009-2014) such as extension of the interest subvention of two per cent for labor-intensive sectors and the Export Promotion Capital Goods Scheme till March 2013 are highly appreciable. However, exports still face many problems, which impact their price-cost margins and impinge their competitiveness in the international markets. Some of the major problems faced by the Indian exporters are hereunder:-

- a) The sluggish business sentiment coupled with high raw material and overhead costs and long payment terms have resulted into drying up of profit margins and has adversely affected the employment scenario.
- b) The key bottleneck in our exports is the inadequate and high cost of infrastructure, particularly, the power, roads, and ports facilities. The high freight costs and low level of logistics efficiency of ports impinge exporter's competitiveness.
- c) The delays in shipping of high quality and high value products from exporters to final consumers, particularly for the pharmaceutical and food processing exports affects the quality of the good exported.
- d) In the current situation, each and every country is formulating more and more liberal and incentivised fiscal policies to boost the exports of their country and therefore our policies should also be framed keeping in view the practices adopted by our competitors.
- e) There is a need to tap the untapped markets such as Canada, Vietnam etc. Focus Product Scheme, Focus Market Scheme and Market Linked Focus Product Scheme are the promotional schemes which have been useful in diversifying export products and markets.
- f) Infrastructure development relating to exports should be given high priority during next 5 years, either by increased public investment or through public private partnership. Infrastructure development would help in reducing the transaction costs and would make our exports much more competitive.
- g) The financial incentive could be the extent of 5% to be given by the center to the state for promoting exports. A scheme could be worked out for this purpose. Supposing, exports from a particular state amount to Rs.500 crores then 5% of Rs. 500 crores could be given to the states for promoting exports.
- h) Since electricity is in short supply and there are power cuts in almost all states throughout the country, the scheme for providing electricity could be worked out as follows: " A unit exporting 50% of its production would face normal power cuts": " A unit exporting 50-75% of its production then the unit would face 25% of the normal power cuts: "Units exporting 75% would face no power cuts."
- i) There is need to provide cheap and timely credit to our exporters. In fact, export credit should be at a rate closer to LIBOR rate. The Government must address issues of concern such as high costs of

inputs that are not inline with international prices. It is suggested that customs duty on raw material and other inputs should be reduced.

- j) The country should enter into Free Trade Agreements with Africa, and other developing countries which will make the Indian industry more competitive and global. Further, with a view to facilitate operational convenience, it is suggested that number of SEZs should be increased.

4.5 Infrastructure to push growth on high road

The role of infrastructure development is crucial in the current economic scenario. Extensive and efficient infrastructure network is not only important for sustainable and all-inclusive economic growth but also crucial for enhancing manufacturing competitiveness. However, with poor quality of roads, shortages of power-supply and inadequate ports and airports infrastructure, infrastructure has emerged as the biggest challenge to sustain the high economic growth in India.

To accelerate the pace of infrastructure development, the Government of India has initiated various projects to reduce deficits in crucial sectors. Tremendous investment activity has been seen in the telecom services, power, ports, civil aviation, railways and roads. As per the Eleventh Five Year Plan (2007-12), over US\$514bn investments have been estimated in various infrastructure projects. Investment in infrastructure has reached around 7-8% of the GDP in the recent years.

India is ranked 86th out of 139 countries in the quality of overall infrastructure. It is much below in comparison with the other emerging economies such as China at 50, Brazil at 62. Many advanced economies and financially constrained developing economies have developed their infrastructure successfully through public-private partnerships. Although, India has made decent progress in this front, there is huge room for further growth. Public sector investments have grown at a modest average annual growth rate of 12% vis-à-vis an average annual growth of 20% in private sector investment during the 11th Five Year Plans period.

Going ahead, infrastructure still has a huge untapped potential and this sector could be the main driving force for achieving double digit economic growth. Government should step up investment in infrastructure to promote industrialization and economic activity, process of unveiling the Infrastructure Debt Fund to meet the infrastructure funding requirements should be expedited. Apart from the financial constraint, there are several non-financial constraints particularly land acquisition delays that need to be addressed.

4.6 Manufacturing reforms to enhance production possibilities

The situation of the manufacturing sector in India is a cause of concern especially when seen in comparison to the massive transformation registered in this sector by other Asian countries in similar stages of development. At 15.8% value added of manufacturing to GDP, the manufacturing sector in India does not seem representative of its potential. The lackluster performance in this sector also has its socio economic implications in the form of over dependence on agriculture for livelihood, disguised unemployment and urban unemployment. For a country with the largest young population in the world, this creates a challenge of significant magnitude.

As manufacturing has immense potential to create employment opportunities, The National Manufacturing policy has been envisaged to make India a manufacturing hub. The policy aims to promote investments in the manufacturing sector, to increase the sectoral share of manufacturing in GDP to 25% by 2025, to double the current employment level in the sector, and to enhance its global competitiveness. In order to trigger manufacturing growth, a set of initiatives could facilitate the smooth development of this sector:

- a) To enhance manufacturing competitiveness, the government should fast track the implementation of the new National Manufacturing Policy
- b) Micro, small and medium enterprises, are generally more labour absorbing, and are also potential seedbeds for innovation and entrepreneurship. Credit should be made available to them at 2% lesser than the base rate norm of banks.
- c) Skill-building in manufacturing targeted at the minimally educated workforce entering the non-agricultural sector for the first time and/or seeking seasonal employment is the need of the hour.
- d) Efforts towards enhancing employability of the 'skilled' workforce by upgrading the technical and vocational curriculum, job-oriented training programmes and building additional capacity, should be made
- e) Industrial development may have been hindered by political backtracking and impasse on land acquisition, GST, delay in environmental clearances and other regulatory clearances. These processes should be expedited.

4.7 Energy reforms to fuel growth

Reforms in the energy sector are also the need of the hour. Disparities in the pricing mechanism, slow policy reforms, unattractive fiscal regime and inadequate infrastructure pose a threat to energy security. The demand for coal has continuously grown which is amounting to the rising current account deficit (CAD). It has been estimated that coal imports may expand by 25% in value terms in fiscal year 2013 and this would add an incremental 0.2% to India's CAD. India currently faces a massive shortage of coal which is jeopardizing the functioning of the power sector and other end-use sectors. Thus, there is a need to introduce competition in the coal sector, along with the involvement of mine development operators, who will infuse both capital and technology in the mining sector and help in boosting our domestic production.

4.7.1 Coal reforms

Driven by the rising population, expanding economy and a quest for improved quality of life, energy demand is escalating at a very fast speed. Hence to match the demand-supply gap of energy requirement, reforms in coal sector is essential to take our country forward. Coal plays significant role in India's industrial output growth, as our industries are largely dependent on indigenous coal production and around 66% of India's power generation is coal based. There is enormous potential for coal exploration in India, but the resources are largely untapped while many projects remain under implemented due to procedural hassles. Thus the coal sector in India promises tremendous avenues for investors which could be harnessed to pave the way towards a sustainable and environment friendly economic growth.

- a) Issues like land acquisition, forest and environmental clearances, law and order concerns have inhibited the smooth implementation of coal mining. These clearances should be expedited.
- b) Rapid infrastructure development in the form of providing proper road connectivity and rail wagons for facilitating easy transportation of coal to industries is the need of the hour.
- c) Modernisation and technology upgradation is urgently required to achieve desired growth in coal production and in this regard private investments should be attracted in coal mining and other related infrastructure.
- d) Illegal mining is another grey area which needs be checked with priority. The government should closely examine the issues related to tampering of official records, including records relating to land and boundaries to arrest illegal mining.
- e) It is also necessary to break the Coal India's monopoly in coal mining and the time is opportune to invite private sector participation by unveiling investment inducing policies in this sector.

4.8 Fast track implementation of GST to spur growth

Goods and Service Tax (GST) is the biggest reform for the economy. The delay in introduction of GST due to lack of political consensus is hampering the growth of the economy. GST would lower the tax rate by broadening the tax base and minimize exemption. It would increase the tax collection and bring about a change on the tax firmament by redistribution of tax burden equitably between manufacturing and services. It will also promote exports and employment and help in spurring the growth.

Domestic trade in India is impeded by one of the most complicated and elaborate sales taxes systems in the world. The implementation of GST will include central and state taxes and bring further simplification in tax structure by removing current inefficiencies/ distortions. It will provide a more enabling environment for India's trade and industry and lead to a single common market across the Indian states.

The government must not let the impasse on GST to carry on longer and should expedite the process so that the new system of taxes could be rolled out at the earliest. The legislative process should be completed in consultation with the states and resolve all pending issues relating to design so that the tax could roll at the earliest. This will enable existing players to plan their projects and factor in their cost of operation.

4.9 Subside subsidies to improve fiscal health

Recently India's fiscal deficit has spiralled completely out of control in recent times. The gross fiscal deficit as a percentage to GDP is likely to shoot up significantly as compared to the anticipated level of 5.1% in FY2013. The mounting subsidy burden of the government is set to impact the overall health of the economy. It is felt that the growing subsidy burden of the government has shrunk its funds which could be diverted towards capital formation. This situation could escalate in the coming years making the fiscal burden uncontrollable, going forward. At this juncture, the government should take steps to reduce structural fiscal deficits and to improve the country's investment climate.

- a) The need is to provide a framework for better targeting of subsidies to the absolutely needy so that funds can be used for asset creation in agriculture and infrastructure.
- b) Fiscal measures like efficient use of fuel and fertilizer (urea) subsidies could be efficient in pruning the fiscal burden
- c) The decontrol of petrol prices has not done much to reduce the subsidy bill especially as diesel, kerosene and LPG continues to be subsidised. Hence, it is necessary to deregulate diesel prices to ease the burden of fuel subsidies with the government. However, the move to hike the diesel prices by Rs5/litre is a welcome step towards this end.
- d) The power subsidies should be funded through state budgets, not through State Electricity Boards.

4.10 Focus on inclusion critical to sustain growth

Improving social sector outcomes is also an important challenge to achieve higher and sustainable economic growth. Though India has emerged as second fastest moving economy among the large emerging markets, the developmental situation, especially at the social front is not satisfactory India ranks a low 134 among 187 countries on the 2011 Human Development Index published by the United Nations Development Programme.

Even as education and health outcomes have improved over the years, on many indicators such as life expectancy at birth, educational attainment and nutrition levels, we rank well below average. Among the many lacunae of our social sector programmes is that we continue to emphasize outputs and not outcomes. For improving service delivery, we need to spend more on the twin merit goods of primary education and basic health. But we also need to spend more efficiently, because better education and health are a function not just of the quantum of expenditure but also of the quality of that expenditure.

- a) Much can be done to clean up the public distribution system and eliminating leakages.
- b) Although the social sector schemes are meant for ensuring inclusive growth of the country, the effectiveness of implementation varies greatly across states. The need is to make them more flexible according to the requirements of states.
- c) Efforts need to be taken for building productive assets through NAREGA
- d) Government should facilitate the skill development activities with not only providing debt schemes, but should also provide the equity exposure. Allocations for National Skill Development Fund should be enhanced and the outreach of the skill developmental activities should be widened to the grass-root level.

The reforms in the education sector which are pending in the parliament are also critical for achieving the supply side response. Reforms in the education sector will help in skill formation and expanding training and education capacities in the economy. Without improvement in the regulatory framework and capacity expansion, the country will lose the demographic advantage that it possesses.

5. Conclusions

The new era of reforms have immense potential to enhance India's growth potential by boosting productivity, investments, and human capital. We believe that with the advent of these reforms, India could achieve double-digit growth on a sustained basis in the next very few years. These reforms will not just push growth, but also help India rebalance its economy on both the supply and the demand side.

On the supply side, India relies heavily on its service sector as the key growth engine instead of the manufacturing sector. However, structural reforms should help India better utilise its comparative advantage in labour intensive and low-skilled manufacturing, which could help the manufacturing sector emerge as a key engine of growth. On the demand side, reforms will help strengthen India's competitiveness and ability to increasingly rely on external demand for growth.

Demographics are in India's favour because the working age population is growing faster than the overall population. This expanding working age population will earn, and will save, thereby contributing to higher savings and higher investment, which will lead to higher growth trajectories, going forward. However, the growing workforce could prove advantageous only if sufficient investment is undertaken to generate their labour productively. Effective education and skill development hold the key to reaping the emerging demographic dividend in case of India.

In a nutshell, the government should undertake measures to improve health, education and agriculture, improve infrastructure to reduce regional disparities and facilitate communication and to improve governance to raise the quality of public services. Beyond this, reforming expenditure to more accurately target subsidies to the poor and making progress on the financial front should be a priority in the reforms agenda. We believe the Indian economy will continue to be shining at the world economic stage in the coming decades as a gradual pick-up in reform momentum ensures a higher growth trajectory, going forward.

India: Statistical Snapshot

Indicators	FY06	FY07	FY08	FY09	FY10	FY11	FY12
GDP at FC - Constant prices Rs Bn	32 542	35 660	38 990	41 625	44 937	48 778	52,220
GDP at FC - Constant prices growth YoY	9.5	9.7	9.2	6.7	8	8.5	6.9
GDP at MP-current prices Rs. Bn	36,925	42,937	49,864	55,826	65,502	78,756	89,121
Agriculture growth	5.1	4.2	5.8	-0.1	0.4	6.6	2.8
Industry growth	9.7	12.2	9.7	4.4	8	7.9	3.8
Services growth	11	10.1	10.8	10.1	10.1	9.4	8.8
Domestic Consumption	6.7	5.9	8.3	5.4	5.3	8.7	6
Private consumption	6.8	6	8.5	2.9	7.3	8.6	6.4
Gross domestic savings as % of GDP	33.4	34.6	36.8	32	33.8	32.3	33.0
Gross Fixed Capital Formation as % of GDP	30.3	31.3	32.9	32.3	31.6	30.4	31.9
Gross fiscal deficit of the Centre as a % GDP	4	3.3	2.6	6	6.4	5.1	5.9
Gross fiscal deficit of the states	2.4	1.8	1.5	2.4	3.3	2.5	2.28
Gross fiscal deficit of Centre & states	6.4	5.3	4.1	8.4	9.5	7.3	8.18
Gross borrowings of Centre Rs Bn	1,600	1,793	1,882	3,185	4,924	3731	3921
Total liabilities of the centre Rs. Bn	22601	25386	28374	31591	35159	39311	43526
Total liabilities of the state Rs. Bn	11477	12416	13283	14702	16385	18202	-
Merchandise exports (US\$Bn)	103.1	126.4	162.9	185.3	178.7	251.1	309.8
Growth in exports	23.4	22.6	29	3.4	-3.6	40.5	23.5
Imports (US\$Bn)	149.2	185.7	251.4	287.7	288.3	369.7	434.2
Growth in imports (YoY)	33.7	24.5	35.4	14.3	0.2	28.2	29.4
Trade deficit (US\$Bn)	46.1	59.3	88.5	118.4	109.6	118.6	166.8
Net invisibles US\$Bn	42	52.2	75.7	89.9	80	84.6	52.9
Current account deficit US\$Bn	-9.9	-9.6	-15.7	-28.7	-38.4	-44.3	(-)16.9
Current account deficit as % of GDP	1	0.6	1.5	2.6	3.2	2.6	3.6
Net capital account US\$Bn	25.5	45.2	107.9	8.6	53.4	59.7	18.4
Overall balance of payments US\$Bn	15.1	36.6	92.2	-20.1	13.4	13	5.7
Foreign exchange reserves US\$Bn	151.6	199.2	309.7	252	279.1	304.8	294.9
External debt - Short term US\$Bn	19.5	28.1	45.7	43.4	52.3	65	71.5
External debt - Long term US\$Bn	119.6	144.2	178.7	181.2	208.7	241.5	255.1
External debt - Gross US\$Bn	139.1	172.4	224.4	224.5	261	306.4	326.6
Money supply growth	16.9	21.7	21.4	19.3	16.8	15.9	14.4
Bank credit growth	37	27.6	21	17.5	17.1	21.2	16.8
WPI inflation	4.4	6.5	4.7	8.1	3.9	9.5	8.2
CPI inflation	4.2	6.8	6.2	7	12.3	10.4	8.4
Exchange rate Rs/US \$ annual average	44.2	45.2	40.2	46	47.4	45.5	47.7

Source: PHD Research Bureau compiled from various sources



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