



**PROGRESS HARMONY DEVELOPMENT**

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# **Economy on the eve of Union Budget 2015-16**

## **India Poised to Enter Double Digit Growth Trajectory**

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**PHD Research Bureau**

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## Economy on the eve of Union Budget 2015-16

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## Economy on the eve of Union Budget 2015-16

### Executive Summary

The economy of India has done very well on the growth front, when viewed in a long term perspective. Consequently, the GDP growth rate has already improved to 7.4% in the first half of this year as compared to 7.1% in the corresponding period of 2013-14. The government and the RBI has been working aggressively in pushing India into high growth trajectory and containing inflation at the same time. The government ambitious programme of “Make in India” is aimed at making India a manufacturing hub and to take manufacturing growth to 10% on a sustainable basis.

Today India stands at an intriguing juncture with its transformation into a vibrant, rapidly growing economy which is diverse and embraces a huge area including agriculture, mining, textile industry, manufacturer and vast areas of service sector.

Though the government since its formation has made significant announcements, still a lot needs to be done. The role of infrastructure development is crucial in the current economic scenario. 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. The GDCF has increased from Rs.8199.25 billion in 2003-04 to Rs.21832.6 and Rs.22978.1 billion in 2011-12 and 2012-13 respectively.

The agriculture sector represents the most important sector of our country as more than 50% of population is still dependent on it. 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. Henceforth, the government must take concerted and focused efforts for addressing the challenge of stagnating productivity and disrupted delivery in agricultural output. Minimizing the wastages by augmenting storage capacities, modernizing/ upgrading the godowns, increasing public investments in agriculture sector, ensuring credit availability to small & marginal farmers to adopt modern farm techniques, removing hurdles in the marketing, technology to improve the yield/productivity along with expanded irrigation facilities and fertilizer availability, strengthening the role of agricultural universities are some of the critical steps that can push agriculture growth. Proper implementation of these steps can help push the growth of the sector to a higher level. Going ahead, we expect the sector to grow by 4% in the coming times.

The industry sector is also expected to witness rapid growth as the government has been taking significant measures to facilitate ease of doing business. We expect the sector to grow at 10% by 2018. The service sector on the other hand, has maintained growth momentum with 60% share in India’s GDP. Going ahead, we expect that the sector will grow at 9% in the medium term. The implementation of GST is also expected to boost India’s GDP by 2 percentage points.

Infrastructure sector has a huge untapped potential and it will be the main driving force for higher economic growth, going forward. Higher growth in infrastructure sector will provide huge

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employment opportunities, which in turn will boost consumption growth in the higher trajectory and enhance the production possibility frontier. The construction sector accounts for second highest inflow of FDI after the services sector and employs more than 35 Million people. Present levels of urban infrastructure are inadequate to meet the demands of the existing urban population. With the growing population and rising disposable income, this sector is expected to gather pace and register a growth rate of 7% by medium term.

Foreign direct investment is a lead economic component which indicates the investment climate in the economy and helps build investors' confidence domestically and internationally. In order to give much needed push to FDI in the infrastructure sector, 100% FDI under automatic route in construction and operation and maintenance in specified Rail Infrastructure projects has been allowed. Further, in order to boost real estate industry, the new government has relaxed rules for FDI in the construction sector by reducing minimum built-up area as well as capital requirement and easing the exit norms.

With respect to capital account liberalization, several initiatives on the part of the government are required. Over the period of time, Government has taken several measures such as the promotion of foreign portfolio investment, NRI deposits, ADRs, GDRs, further liberalization of External Commercial borrowings etc for furthering capital account liberalization. Further, government is working on various measures to boost the pace of special economic zones (SEZs) in order to facilitate ease of doing business.

These measures will refuel growth of the sectors and rejuvenate India's growth story by pushing it into double digit trajectory by 2018. In this regard, the forthcoming Union Budget 2015-16 should address certain critical issues such as early implementation of GST, lowering of MAT, rationalization of CENVAT credit scheme, reforms in the energy sector, bringing MSMEs definition in India towards global standards, collateral free lending for MSMEs, promotion of NBFCs, addressing inverted duty structure problem and enhancement of excise limit for MSMEs manufacturing units.

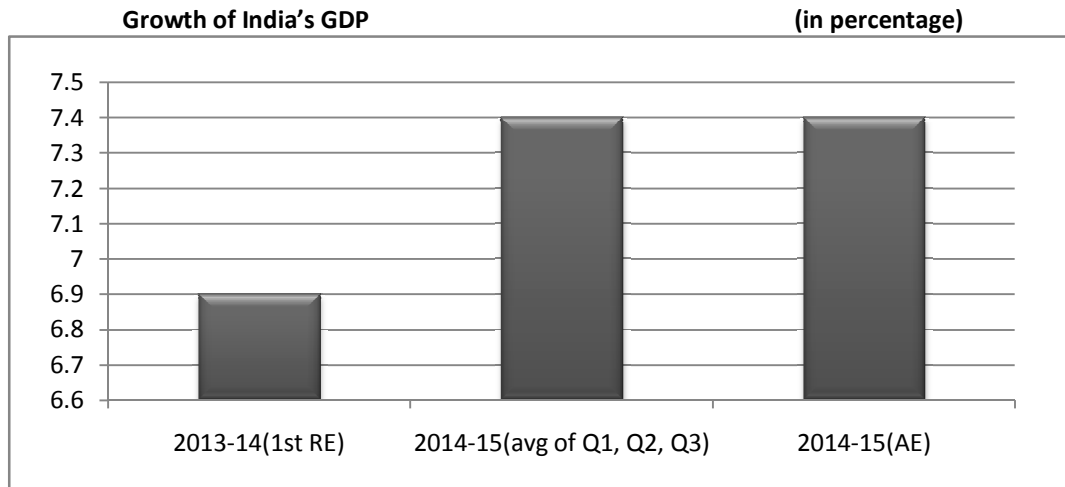
Going ahead, we believe India will grow at double-digit growth rate by 2018 due to the various reforms which are expected to be implemented by the new government in coming years and high growth in all the sectors which will push India's GDP to 10% in the medium term. Against this backdrop, PHD Chamber look forward for calibrated policy measures to achieve sharp economic outlook and outcomes.

## Economy on the eve of Union Budget 2015-16

### 1. Introduction

The economy of India 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.

The growth rate of the economy in the 1990s, averaging around 5.7%, was not very different from that in the 1980s. However, 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 Central Statistics Office (CSO), Ministry of Statistics & Programme Implementation has released a new series of national accounts, revising the base year from 2004-05 to 2011-12 for measuring the growth. According to the new estimates, the GDP registered a growth of 6.9% in 2013-14 and is expected to increase to 7.4% in 2014-15.



Source: PHD Research Bureau, compiled from ministry of finance

Further, World Bank expects the Indian economy to catch up with China's growth in 2016-17 and believes that it is set to become the fastest-growing big economy in the world in the fourth year of the present government. The World Bank in its report has also forecasted a growth rate of 7% each in the fiscal year 2016 and 2017 as against China's 7% and 6.9% respectively.

The new government in the recent times has taken a number of initiatives such as formulation of a 10-point agenda to kick-start economic growth, followed by various announcements in the Union Budget 2014-15. Subsequently, the road map for reform process has been laid out and a few significant schemes such as Jan Dhan Yojana, Digital India and launch of Make in India have been landmark decisions. Though, a lot needs to be done, few initiatives such as ordinance to

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make major changes in the existing Land Acquisition, Rehabilitation and Resettlement Act 2013, approval to amendments in labour laws along with launching of labour schemes and launch of 11 service on eBiz platform to facilitate ease of doing business are steps in the right direction to improve ease of doing business.

Consequently, the GDP growth rate has already improved to 7.4% in the first half of this year as compared to 7.1% in the corresponding period of 2013-14.

The average saving rate also showed a substantial increase from 23% of GDP in the 1990s to about 31% in the 2000s with a peak saving rate of over 33% achieved during the high growth phase of 2004-08. According to the advance estimates of 2014-15, the saving rate was registered 30.5% in the year 2013-14.

On the socio-economic front, poverty levels across the country declined from 37.2% in 2004-05 to 21.9% in 2011-12, while the employment growth was recorded at 68.48 million between 1999-2000 and 2009-10. Further, India is expected to create 10 million jobs this year.

***Growth drivers***

- *Demand in the economy, especially rural demand*
- *Demography*
- *Investment environment*
- *Infrastructure Development*

## 2. Reforms enhance growth prospects

The new government and the RBI has been working aggressively in pushing India into high growth trajectory and containing inflation at the same time.

The key initiatives of the government which have helped improving the investor sentiments include relaxation in FDI policies, enhancement in FDI limits in insurance and defence, development of 100 smart cities to facilitate infrastructure development, launch of a user-friendly Indian Trade Portal, relaunch of Kisan Vikas Patra Scheme to increase domestic savings, launch of Jan Dhan Yojana to remove financial untouchability, replacement the Planning Commission with the NITI Aayog, launch of labour inspection schemes and launch of the 'Make In India' campaign to boost domestic manufacturing.

The government ambitious programme of “Make in India” is aimed at making India a manufacturing hub and economic transformation while eliminating the unnecessary laws and regulations, making bureaucratic processes easier, make government more transparent, responsive and accountable and to take manufacturing growth to 10% on a sustainable basis.

Further, the government has also initiated the process of e-auction of coal blocks, further liberalised foreign investment policy for protected sectors like defence, railways and reached a long pending consensus on GST paving the way for a single tax for goods and services throughout the country.



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Over the period of time, government's measures to contain inflation such as setting up of Price Stabilization fund with an initial amount of Rs. 500 crore, steps to improve the supply side deficiencies through improving productivity such as soil health card, adaptation fund to mitigate risks of climate change and enhanced agricultural credit has contributed a lot in this direction.

The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry has also announced the launch of 11 Central Government Services on e-Biz portal. These services are required for starting a business in the country - four services from Ministry of Corporate Affairs, two services of Central Board of Direct Taxes, two services of Reserve Bank of India and one service each from Directorate General of Foreign Trade, Employees' Provident Fund Organisation and Petroleum & Explosives Safety Organization. With the integration of these services on eBiz portal, a business user can avail all these services 24\*7 online end-to-end i.e., online submission of forms, attachments, payments, tracking of status and also obtain the license/permit from eBiz portal.

Further, RBI's tight monetary policy stance in the last year, has driven down the WPI Inflation to a considerable extent. WPI inflation decreased from 0.11% in the month of December to (-) 0.39% in the month of January 2015. Going ahead, it is expected that WPI inflation will be in the range of 3-4% in the coming times.

In addition to controlling inflation, RBI in the month of January has taken slew of measures to boost growth also. The central bank in its surprise policy cut reduced repo rate by 25 basis point from 8% to 7.75% and reduced SLR by 50 basis points from 22% to 21.5% in its sixth bimonthly monetary policy review.

### **2.1 Make in India to boost domestic manufacturing and enhance employment**

Make in India is aimed at making India a manufacturing hub and economic transformation while eliminating the unnecessary laws and regulations, making bureaucratic processes easier, make government more transparent, responsive and accountable and to take manufacturing growth to 10% on a sustainable basis.

#### **Objectives-**

- To make investing in manufacturing more attractive to domestic and foreign investors
- To give the Indian economy global recognition
- To create competitive industrial environment
- To development infrastructure
- To invite latest technologies To generate employment and skill formation

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The Make in India focuses on **new ideas** and initiatives such as-

- First Develop India and then Foreign Direct Investment,
- Look-East on one side and Link-West on the other,
- Highways and 'I'-ways.
- facilitate investment
- foster innovation
- protect intellectual property
- build best-in-class manufacturing infrastructure.

### 2.1.1 Initiatives undertaken to facilitate the ease of doing business

- De-licensing and deregulation measures to reduce complexity and ensure increased transparency.
- Online applications for Industrial License & Industrial Entrepreneur Memorandum have been on 24x7 basis. Industrial license have been extended to three years, state governments asked to introduce self-certification.
- Services of all Central Government Departments & Ministries will be integrated with the eBiz – a single window IT platform for services by 31 December 2014.
- The process of obtaining environmental clearances has also been made online.
- All returns should be filed on-line through a unified form and a check-list of required compliances should be placed on Ministry's/Department's web portal.
- Center has advised all the departments that all registers maintained by the businesses should be replaced with a single electronic register
- No inspection to be undertaken without the approval of the Head of the Department.

**Focus Sectors are-**  
 Automobiles  
 Automobile Component  
 Aviation,  
 Biotechnology,  
 Chemicals,  
 Construction,  
 Defense Manufacturing,  
 Electrical Machinery,  
 Electronics Systems,  
 Food Processing,  
 IT & BPM,  
 Leather,  
 Media and Entertainment,  
 Mining,  
 Oil and Gas,  
 Pharmaceuticals,  
 Ports,  
 Railways,  
 Renewable Energy,  
 Roads and Highways,  
 Space,  
 Textiles and Garments,  
 Thermal Power,  
 Tourism  
 Hospitality and Wellness

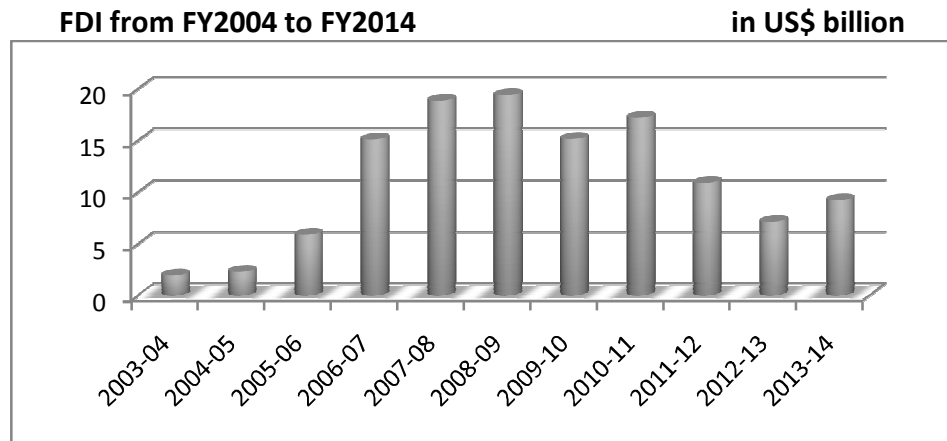
Going forward, the Indian manufacturing sector provide an excellent opportunity to international investors to collaborate with existing businesses as most of the businesses have plans to expand through various options. This also reiterates the fact that the businesses are actively willing to participate in the "Make in India" mission of the government. With various initiatives being implemented by the government to facilitate the ease of doing business, the manufacturing sector in India is expected to pick up pace and will provide immense opportunities to domestic and international investors to come and make in India.

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### 2.2 FDI expands production possibilities

Foreign direct investment is a lead economic component which indicates the investment climate in the economy and helps build investors' confidence domestically and internationally. FDIs can be termed as the single most determinant of economic growth as it infuses technological advancement, enhance production possibilities and induce capital flows, which helps in maintaining general macroeconomic stability in the economy. FDI helps to create technological advancements, increase competitiveness of the industry, enhance capital stock, step up infrastructural base and thus reflects the overall level of prosperity in the economy. Post liberalization of Indian economy since 1990s, India has gone a long way attracting FDI from different economies of the world across an entire gamut of sectors. FDI up to 100% is allowed under the automatic route in most sectors, with a few exceptions.

FDI has increased from \$1.93 billion in 2003-04 to \$15.14 billion in 2009-10. Further, FDI was registered at \$7.13 billion in 2012-13 and \$9.2 billion in 2013-14. However, UNCTAD in its recent Global Investment Trends Monitor has mentioned that FDI inflows to India during 2014, increased by about 26% to an estimated US\$35bn, despite macroeconomic uncertainties and financial risks. In addition, India registered a record deal value from its gas purchase into Mozambique worth US\$2.4bn.

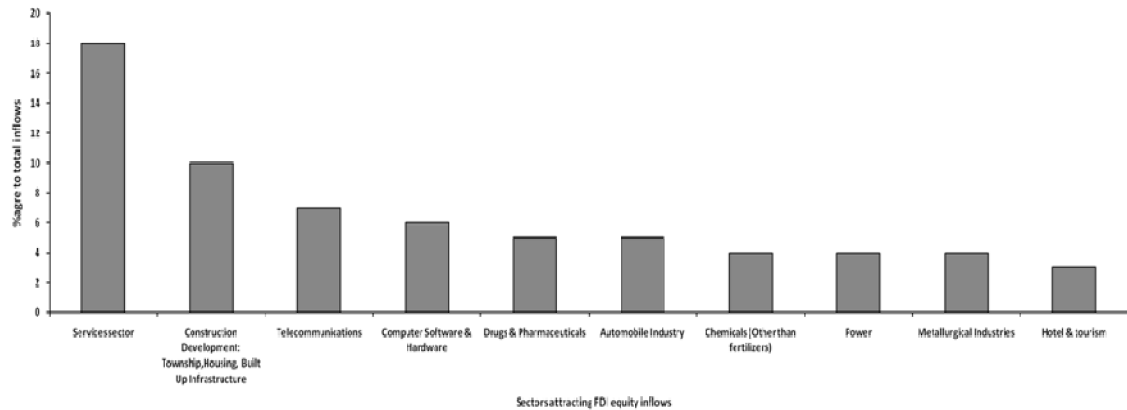


Source: PHD Research Bureau, compiled from Reserve Bank of India

Service sector and construction development constitute the highest share in attracting FDI equity inflows during April 2000-December 2014 of around 18% and 10% respectively. Telecommunications has also been able to attract about 7% of FDI equity inflows during the same period. Computer software and hardware constitutes 6% share while Drugs and pharmaceuticals and Automobile Industry constitute 5% share in total FDI equity inflows. Chemicals (other than fertilizers), Power and Metallurgical Industries constitute share of about 4% in FDI equity inflows and lastly, Hotel and tourism constitute share of about 3% share during the period.

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### Sector wise contribution in FDI equity inflows



Source: PHD Research Bureau, compiled from Department of Industrial Policy & Promotion. The data represents share of sector in total FDI equity inflows for the cumulative period of April'00- December 2014.

Note: \*\* Services sector includes financial, banking, insurance, non-financial / business, outsourcing, R&D, courier, tech. testing and analysis

In order to give much needed push to infrastructure sector, 100% FDI under automatic route in construction and operation and maintenance in specified Rail Infrastructure projects has been allowed. Further, in order to boost real estate industry, the new government has relaxed rules for FDI in the construction sector by reducing minimum built-up area as well as capital requirement and easing the exit norms. The proposal to amend the FDI policy in construction development sector was approved by the Union Cabinet.

In view of depleting FDI inflow in construction and real estate sector in last few years, the Cabinet has decided to reduce the minimum floor area to 20,000 sq mt from the earlier 50,000 sq mt. It also brought down the minimum capital requirement to USD 5 million from USD 10 million. In case of development of serviced plots, the condition of minimum land of 10 hectares has been completely removed.

These measures are expected to result in enhanced inflows into the construction development sector. It is likely to attract investments in new areas and encourage development of plots for serviced housing given the shortage of land in and around urban agglomerations as well as the high cost of land. The measure is also expected to result in creation of much needed low cost affordable housing in the country and development of smart cities.

The government of India has also liberalized the policies for foreign Institutional Investments to promote greater investments in a wider range of sectors. With respect to capital account liberalization, several initiatives on the part of the government are required. Over the period of time, Government has taken several measures like promotion of foreign portfolio investment, NRI deposits, ADRs, GDRs, further liberalization of External Commercial borrowings etc for furthering capital account liberalization.

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To attract higher FDI in the economy, government is working on various measures to boost the pace of special economic zones (SEZs) in order to facilitate ease of doing business. Steps that are currently under various stages of implementation for SEZs are those related to timely service delivery, digitization and online processing of various activities related to SEZs and standardization of procedures in all SEZs.

Online processing of various activities that take place in the SEZ units and developers has already been made effective. Besides, the government has also implemented standardization of procedure, practices and forms in all SEZs.

Going ahead, to give a boost to India's special economic zones (SEZs), government must reduce the minimum alternate tax (MAT) on special economic zones (SEZ) from the current level of 18.5% in the upcoming union budget.

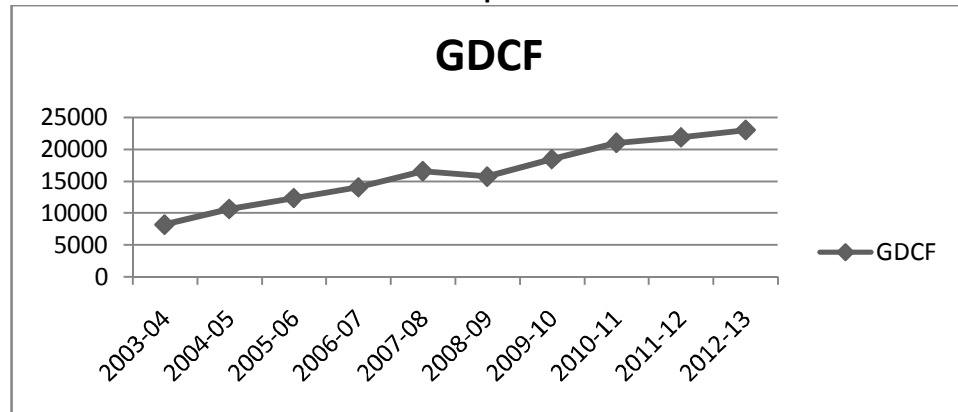
The domestic investments on the other hand have been growing significantly. In the 7th edition of Vibrant Gujarat Summit, about 21,000 MoUs were signed which are expect to invest around Rs 25 lakh crore. A whopping 21,000 Letters of Intent (LoI) worth of Rs. 25 lakh crore were signed during the Summit. In addition, 1,225 strategic partnership agreements were signed during the summit, which saw participation of over 25,000 delegates from 110 countries. The proposals also include creation of lakhs of jobs.

### **2.3 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.

To accelerate the pace of infrastructure development, the Government of India has initiated various projects to reduce deficits in crucial sectors. The GDCF has increased from Rs.8199.25 billion in 2003-04 to Rs.21832.6 and Rs.22978.1 billion in 2011-12 and 2012-13 respectively.

**Economy on the eve of Union Budget 2015-16****GDCF at constant prices in Rs. billion**

Source: PHD Research Bureau, compiled from RBI

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.

While investment in infrastructure was the main driver of growth before the global financial crisis, it has been lacklustre since then. Both macro-economic and structural factors are responsible for the recent weakening of infrastructure investments. The time is most opportune to provide better policy environment that will reassure investors' confidence and nudge entrepreneurs to invest. The following measures could increase 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. The ordinance on Land Acquisition, Rehabilitation and Resettlement Act 2013 has been passed. We look forward to the implementation of the ordinance.
- b) 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. Going ahead, we expect the RBI to reduce the repo rate which would increase industrial investments.
- c) Raising FDI Limits in railway infrastructure and insurance is a welcome move. The decision of government to allow 49% FDI in insurance is the step in right direction. 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.
- d) 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.

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### 2.4 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). 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.

### 2.5 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.

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.

In the Interim budget 2014-15, several announcements were made for the sustainable growth of the agricultural sector, such as an amount of Rs. 100 crores set aside for Agri-tech Infrastructure fund, a sum of Rs. 1000 crore provided for “Pradhan Mantri Krishi Sinchayee Yojna” for assured irrigation, allocation of Rs. 5,000 crore provided for the Warehouse Infrastructure Fund, corpus of Rural Infrastructure Development Fund (RIDF) raised by an additional Rs. 5000 crores from the target given in the Interim Budget to Rs. 25000 crores, to meet the vagaries of climate change a National Adaptation Fund with an initial amount of Rs. 100 crore would be set up, a sum of Rs. 200 crore allocated to open Agriculture Universities in Andhra Pradesh and Rajasthan and Horticulture Universities in Telangana and Haryana and an amount of Rs. 50,000 crore allocated for Short Term Cooperative Rural Credit. **It is expected that these agricultural reforms will push the growth rate of agriculture to 4%.**

These announcements are appreciable but 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

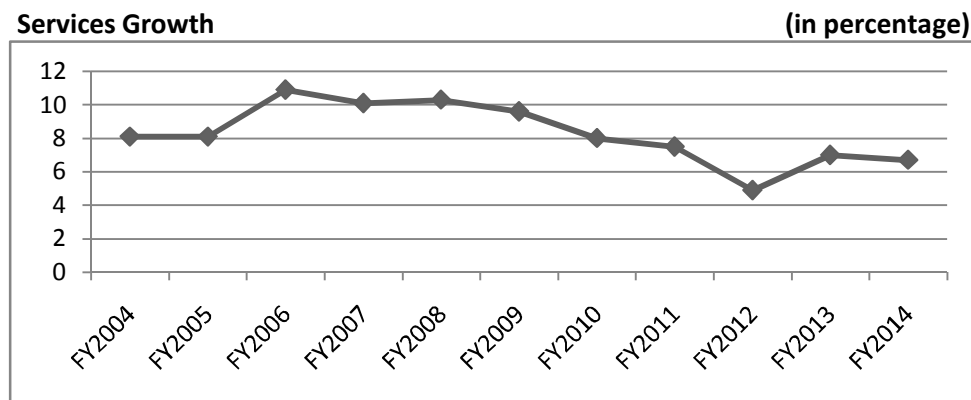
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also to tackle food inflation vis-à-vis removing output gaps and sustaining higher economic growth. Concerted and focused efforts are required for addressing the challenge of stagnating productivity and disrupted delivery in agro output. Minimizing the wastages by augmenting storage capacities, modernizing/ upgrading the godowns, increasing public investments in agriculture sector, ensuring credit availability to small & marginal farmers to adopt modern farm techniques, removing hurdles in the marketing, technology to improve the yield/productivity along with expanded irrigation facilities and fertilizer availability, strengthening the role of agricultural universities are some of the critical steps that can push agriculture growth.

### 2.6 Services Sector maintains momentum

The services sector with an around 60% contribution to the gross domestic product (GDP), has made rapid strides in the last few years and emerged as the largest and fastest-growing sector of the economy. Besides being the dominant sector in India's GDP, it has also contributed substantially to foreign investment flows, exports, and employment. According to DIPP, the Indian services sector has attracted the highest amount of FDI equity inflows in the period April 2000-September 2014, amounting to about US\$ 40,684.98 million which is about 18 per cent of the total foreign inflows. India's services sector covers a wide variety of activities that have different features and dimensions. Some services like IT and telecommunications are very sophisticated, involving high technology and expertise, while some are simple like those of barbers and plumbers.

During the last 10 years, the services sector also witnessed a deceleration with growth rate averaging 8.3% during the period FY2004 to FY2014. In FY2006, the sector witnessed highest growth at 10.9% after which it decreased till FY2012. In FY2013, services sector grew to 7% from 4.9% in FY2012. In 2013-14, the sector registered a growth of 6.7%.



Source: PHD Research Bureau, compiled from various sources

The contribution of the Services Sector has increased rapidly in the India's GDP as India has a large pool of highly skilled, low cost, and educated workers in the country. This has made sure that the services that are available in the country are of the best quality. The foreign companies seeing this have started outsourcing their work to India especially in the area of business



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services which includes business process outsourcing and information technology services. This has given a major boost to the Services Sector in India, which in its turn has made the sector contribute more to the India's GDP.

With the liberal foreign direct investment (FDI) policies of the government, the sector has attracted the highest amount of foreign equity among all other sectors in the Indian economy. The Reserve Bank of India (RBI) has eased the guidelines for issue of shares or convertible debentures under the automatic route which will allow companies to issue equity shares to a resident outside India against any type of fund. The norms allow issuance of shares subject to conditions such as entry route, sectoral cap, pricing guidelines, and compliance with the applicable tax laws.

With increase in standard of living, growing disposable income and demand for quality healthcare, sectors such as healthcare services and insurance are expected to grow significantly. Thus, the sector must be given boost. The Indian government must take steps in order to ensure that Services Sector Growth Rate in India's GDP continues to rise. **Going ahead, we expect the sector to grow at 9% in the medium term.**

### **2.7 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. India ranks 156 in paying taxes in Doing Business Rankings 2015 Report of World Bank. 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. **It is expected that implementation of GST will increase GDP by 2 percentage points.**

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.

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### **2.8 Policy focus on rural development and inclusive growth**

The Indian economy, which has over the last six decades passed through various phases of growth, is now all set to enter an altogether different orbit: one marked by a high rate of expansion, combined with 'inclusive growth'. There is a need for the public and the private sector in India to have a unified approach towards how they can extend, innovate, and collaborate in new ways to drive inclusive growth. Rapid and sustained poverty reduction requires inclusive growth that allows people to contribute to and benefit from economic growth.

The inclusive growth approach takes a longer term perspective as the focus is on productive employment rather than on direct income redistribution, as a means of increasing incomes for excluded groups. In the short run, governments could use income distribution schemes to attenuate negative impacts on the poor of policies intended to jump start growth, but transfer schemes cannot be an answer in the long run and can be problematic also in the short run.

Inclusive growth is necessary for sustainable development and equitable distribution of wealth and prosperity. Achieving inclusive growth is the biggest challenge in a country like India. In a democratic country like India, bringing 600 million people living in rural India into the mainstream is the biggest concern. The challenge is to take the levels of growth to all section of the society and to all parts of the country.

Various interrelated elements of inclusive growth are poverty Reduction, employment generation and Increase in quantity & quality of employment, Agriculture development, Industrial development, Social sector development, reduction in regional disparities, protecting the environment, equal distribution of income.

Since improving the quality of life in the rural areas of the country is one of the pre-requisites of social development, special emphasis is on the need and importance of rural development for inclusive growth of the country. Some recent provisions like development of rural roads and other rural infrastructure, remuneration under MGNREGA linked with CPI, increased access to banking facilities in rural areas, increase in agricultural productivity, availability of irrigation facilities, provision of seeds, fertilizers and insecticides to farmers at affordable prices, easy availability of credit to startups and MSMEs, have contributed positively to the rural development and inclusive growth objective of the government.

#### **2.8.1 Huge potential for demographic dividend**

Demographic dividend refers to a period – usually 20 to 30 years – when a greater proportion of people are young and in the working age-group. This cuts spending on dependants, spurring economic growth. India is hoping by the time this dividend phase ends around 2045, it would have achieved a stable and balanced population. However there are a number of challenges facing the country that impact on this.

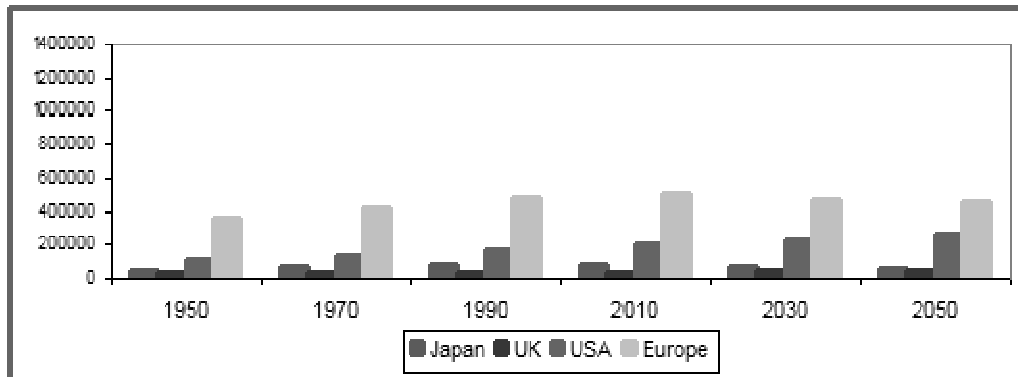
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The low sex ratio remains one of the most disquieting features of India's population growth. In a country with a strong culture of son-preference, mushrooming of neo-natal clinics has made it easy for parents to detect the sex of their unborn child and abort if the child is a girl. Misuse of advanced prenatal diagnostic techniques has led to sex selection with the widespread termination of female fetuses, contributing to a rapidly declining girl to boy child sex ratio. Unless urgent action is taken across all sectors to reverse this trend to eliminate gender discrimination and restore a balanced population, the social repercussions for future generations could be devastating.

Around 50 crore people in India are under-20 years of age and, thus, will be under the working age in the next 20 years, implying a need for the creation jobs to tap this demographic dividend. India is well positioned to make the most of a growing population of working age. However, to reap the demographic dividend, India will have to manage the demand and supply of skills and labour carefully. While the government has introduced policies to improve access to education, much more needs to be done to improve the quality of education, standards of teaching, methods of examination, development of skills, vocational programmes, etc. In order to make Right to Education policy effective, the country should also address the challenges of bridging the gaps between children from disadvantaged and advantaged backgrounds being able to study together and better understand, respect and befriend each other. In the new year, India should look to develop public-private partnerships and social entrepreneurship programmes that can ensure livelihoods for its young population.

Over the 20 years from 1990-2010, the fastest growth in working-age population occurred in Asia, Africa and the Middle East. Globally, the working-age population (15-64 years) increased by 40% (1.3bn) with Asia accounting for two-thirds of worldwide growth. Due to declining fertility rates, many economies will see their work forces peaking and level off or even begin to shrink within the next 40 years. Among the advanced economies, only the US and the UK will see growth in working-age population. Work forces in Japan are already shrinking and Europe is currently witnessing very slow growth rate, which will turn negative by 2020.

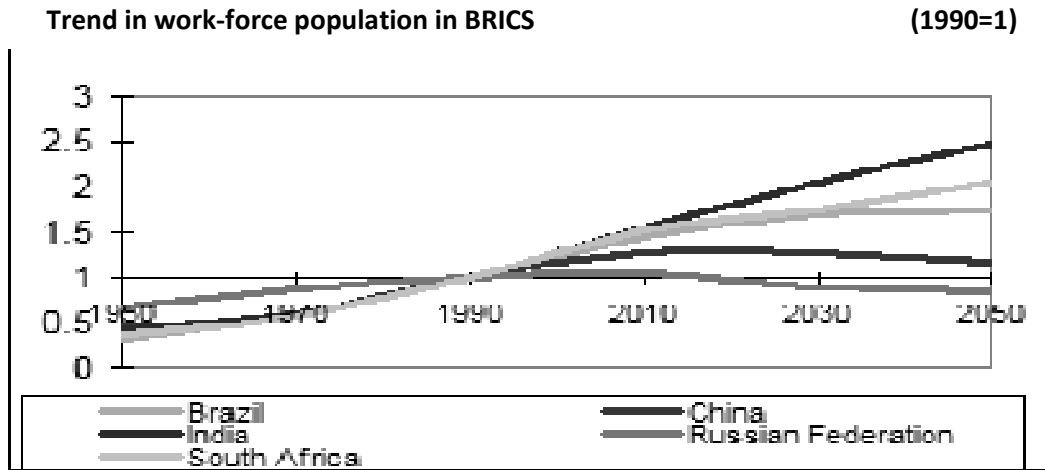
**Trend in working population for select advanced economies (in 1000's)**



Source: PHD Research Bureau, compiled from United Nations

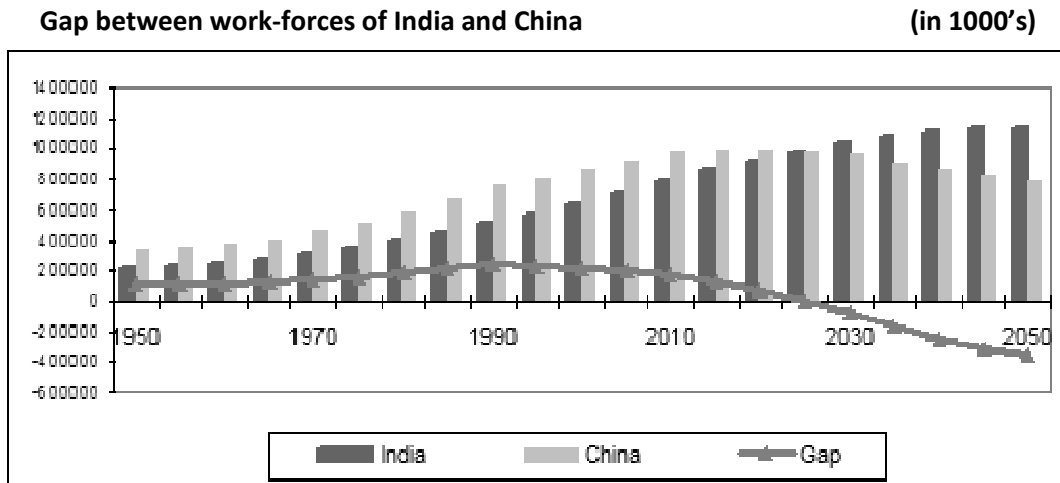
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As for the BRICS, they exhibit a divergent pattern of work-force growth. Russia's working age population would decline 2010 onwards. China's work-force will peak till 2015, before it starts declining. South Africa would also benefit from growth in work-force to the tune of around 4% per annum, on an average, from 1950-2050.



Source: PHD Research Bureau, compiled from United Nations Values indexed to 1990;

China's shrinking workforce 2015 onwards may affect its economic growth prospects. A combination of a shrinking workforce and ageing will put pressure on social services, potentially increasing the tax burden on the working population. On the other hand, India will continue enjoying a growing and young workforce, enabling its economy to benefit from a demographic dividend in the coming years. However, this huge consumer base for India has the potential to pose a challenge on the country's infrastructure and also to create enough jobs for its growing working-age population.



Source: PHD Research Bureau, compiled from United Nations

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### **3. India poised to enter double digit growth trajectory**

Today India stands at an intriguing juncture with its transformation into a vibrant, rapidly growing economy which is diverse and embraces a huge area including agriculture, mining, textile industry, manufacturer and vast areas of service sector. The Indian economy has been witnessing positive sentiments during the past few months. The new series has pushed up economic growth rate up from 7.1% in April-December 2013-14 to 7.4% in the corresponding period of 2014-15. The global economy is still struggling to gain momentum, while many large developing economies are less dynamic than in the past. However, the World Bank expects the Indian economy to catch up with China's growth in 2016-17 and believes that it is set to become the fastest-growing big economy in the world in the fourth year of the present government. According to the IMF's report World Economic Outlook, growth is projected to remain high in emerging Asia, India being one of them. Going ahead, the growth prospects for India look bright and it is likely to enter the double growth trajectory in near future outpacing China.

We believe India will grow at double-digit growth rate in the medium term. The government has been announcing significant reforms in the agriculture sector such as new technologies and state of the art infrastructure in the rural segments and diversification of traditional crops system. In view of these measures to combat the supply side bottlenecks in the agriculture sector, it is expected that the sector will grow at a sustainable growth rate of 4% in the coming times.

Infrastructure sector has a huge untapped potential and it will be the main driving force for higher economic growth, going forward. Higher growth in infrastructure sector will provide huge employment opportunities, which in turn will boost consumption growth in the higher trajectory and enhance the production possibility frontier. The construction sector accounts for second highest inflow of FDI after the services sector and employs more than 35 Million people. Present levels of urban infrastructure are inadequate to meet the demands of the existing urban population. With the growing population and rising disposable income, this sector is expected to gather pace and register a growth rate of 7% in the medium term.

The industry sector is also expected to witness rapid growth as the government has been taking significant measures to facilitate ease of doing business such as the launch of Make in India, approvals to amendments in labour laws, ordinance on Land Acquisition and launch of 11 services on eBiz platform. We expect the sector to grow at 10% in the medium term. The service sector on the other hand, has maintained growth momentum with 60% share in India's GDP. Going ahead, we expect that the sector will grow at 9% by 2018. The implementation of GST is also expected to boost India's GDP by 2 percentage points.

In view of high growth of all sectors, we expect the GDP to enter into double digit and register a growth rate of 10% by 2018.

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### Projections for India's GDP by 2018 based on new series on constant (2011-12 prices)

Components of India's GDP	Current Share in GDP	Anticipated Growth by 2018
Agriculture, forestry & fishing	13.68	4%
Industry	18.93	10%
Services	59.56	9%
Construction	7.81	7%
Implementation of GST	-	2%
<b>Overall GDP growth</b>	-	<b>10.4%</b>

Source: PHD Research Bureau, Economy on the eve of Union Budget 2015-16

#### 4. Expectations of the industry from Union Budget 2015-16

We compliment the Government for big-bang reform announcements and believe that these will refuel India's growth story. The forthcoming **Union Budget 2015-16** is being formulated in a benign macro-economic environment at domestic and international level after many years. The key drivers of economic growth would be creating more and more employment opportunities with increasing the share of manufacturing in GDP to 25%. Inducing demand scenario would be critical to refuel our economic growth trajectory. Also the ease of doing business must be focused seriously as India's ranking in the world tables is not comfortable at 142<sup>nd</sup> in the league of 189 nations. The present tax regime is not conducive for fostering growth, thus, there is an urgent requirement to make our taxation system simplified, rationalized with long term stability.

Substantial relief to individual taxpayers in terms of increasing the income tax slabs should be provided so that more disposable income is available in the hands of individual taxpayers and this could push up demand that is the need of the hour vis-à-vis to reduce our dependence on external markets. Induced demand in the economy will boost manufacturing processes in terms of enhanced capacity utilization and expansion, going forward.

The health scenario of the nation should be focussed by enhancing the income tax exemption limit of Rs. 15,000 for medical reimbursements to at least Rs. 30,000/-. It will help the people to tackle the ever increasing expenses on medicines.

To give a fillip to the construction industry, there is a need to incentivize home loan rebate further. It will reduce the effective EMI burden and generate demand in the economy. Implementation of a well designed Goods and Services Tax (GST) at the earliest, by reducing state border taxes, will have the important consequence of creating a pan India common market for goods and services, which will be critical for our growth in the coming times. Increase in **dividend distribution tax** should be withdrawn as the increase runs contrary to the need to expand Industrial / business activity, relieving the industry from the hardship caused by this hike in DDT.

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The rate of MAT should be below 10% to provide a fillip to manufacturing. The ceiling of Dividend Distribution Tax (DDT) should be at 12.5%. The developers and units in SEZs should be provided relief from MAT and DDT.

The rationalization of CENVAT credit scheme to be considered as a step towards GST, unnecessary qualifications / categorizations within the definition of 'input', 'input service' and 'capital goods' be done away with and all input side tax costs forming part of a business entity's profit and loss account (and forming part of the value of the final output goods/service) should be allowed as credit.

Further, for the avoidance of double taxation on the same service, necessary amendment may be made to provide that once service tax has been paid on a particular service either by the service recipient or by a service provider, no demand of service tax can be made on the other party by the Department irrespective of whose primary liability, it is to pay such service tax. There should be **rationalization of domestic transfer pricing provisions** and as well sought simplification of Section 72A relating to amalgamation and de-mergers and also CSR expenditure should be allowed as an expense of the corporate.

Though the government has provided very lucrative FDI limits to attract foreign investments but creating a conducive business environment at domestic level would be critical to attract more and more domestic and foreign investments. Reforms in the energy sector are needed to stem the increasing energy import dependence and making the policy conducive to facilitate transformation and adaptation. An overall re-hauling of transport system needs to be done. There needs to be an increase in capacity of railways with modernization through state of the art technology. Better utilization of allocated funds, through effective delivery mechanisms, should be an essential component of the developmental objectives of the forthcoming Budget.

In recent years, the share of Gross Capital Formation (GCF) of agriculture & allied sector in total GCF has hovered between 7 to 9% whereas it was around 18% during the early 1980s. Private sector investments are three fourths of total investments in agriculture.

Government policy needs to act as a catalyst by way of providing greater public investments in agricultural research, rural roads, power and irrigation. Higher public investments in these areas will boost private investments in other areas of the supply chain and enhance share of agriculture GCF in total GCF to 15-20% trajectory in the coming times which is desired to achieve a sustainable 4% growth in the sector to address the problem of food inflation and various other macro-economic problems caused by food inflation.

The budget should nudge entrepreneurs to invest more by unveiling investor friendly policies. These policies should include incentives for infrastructure and employment intensive sectors of the economy.

For the growth of manufacturing sector, the MSMEs segment should be looked in seriously. MSMEs have immense potential to create millions of new employment opportunities due to

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labour intensive production processes, however, MSMEs definition in India is limited and far away from global standards. It should be turnover basis; Rs. 1crore to 25Crore for Micro enterprises, Rs25crore to Rs100Crore for Small enterprises and Rs100crore to Rs1000crore for Medium enterprises.

Collateral free lending for MSMEs should be promoted, where appropriate qualitative grading of Promoters and Projects should be available. MSMEs focused NBFCs should be promoted as they are more nimble footed than banks and a better alternative than unorganised financiers and money lenders.

The inverted duty structure, which is a major deterrent for manufacturing in India, should be completely corrected as domestically-produced goods cost more than imported ones. The high transaction costs, both in terms of time taken and the money involved, are adversely impacting manufacturing competitiveness and overall business performance, the budget must provide provisions for reducing transaction costs. Radical decisions are needed on the time taken for paper work and permissions.

The **excise limit for MSMEs manufacturing units** should be enhanced. The small scale units are enjoying Excise Limit exemption of Rs1.5crore on sale ever since 1998. Since then there has been a drastic change in manufacturing costs, the limit of Rs1.5crore is not at all in consonance with current manufacturing costs and therefore the excise exemption limit for the MSMEs may be factored on the basis of difference between the WPI of 1998 to 2014 and the tax exemption limit may be enhanced appropriately.

Employment generating schemes would be critical to absorb vast pool of the young population. Vocational training at School level would foster employability and address the demand supply gap. There is also an urgent need to integrate vocational education with professional and technical education through a proper framework. The budget must make significant allocations to the primary education so that the resources reach the marginalized sections of the society. Overall expenditure on education sector must not be less than 6% of GDP with defined outcomes and deliverables.



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### 5. Conclusions

The Indian economy has done very well on the growth front, when viewed in a long term perspective. International agencies are positive on India's growth and believe that it is set to become the fastest-growing big economy in the world in the coming times.

The new government in the recent times has taken a number of initiatives such as formulation of a 10-point agenda to kick-start economic growth, followed by various announcements in the Union Budget 2014-15. Consequently, the GDP growth rate has already improved to 7.4% in the first half of this year as compared to 7.1% in the corresponding period of 2013-14. Also, the government ambitious programme of "Make in India" aims to take manufacturing growth to 10% on a sustainable basis. Going forward, the Indian manufacturing sector provide an excellent opportunity to international investors to collaborate with existing businesses as most of the businesses have plans to expand through various options.

Foreign direct investment is a lead economic component which indicates the investment climate in the country. Considering this, various capital account liberalization measures have been taken up by the government to attract equity flows in the economy. Further, to attract higher FDI in the economy and to facilitate ease of doing business in the country, government is working on various measures to boost the pace of special economic zones (SEZs) and enhancement of infrastructural investments in the economy.

Taking into account the importance of agricultural sector, various announcements were made in the union budget of 2014-15 for the sustainable growth of the agricultural sector. Further, to enhance the productivity of the agricultural sector in the coming times, more reforms are needed to push the growth rate of the sector to 4%.

The services sector with an around 60% contribution to the gross domestic product (GDP), still remains to be the most important sector for the future development of the economy. With the liberal foreign direct investment (FDI) policies of the government, the sector has attracted the highest amount of foreign equity among all other sectors in the Indian economy. The government should continuously keep on boosting this sector to achieve a double digit growth which is sustainable. Further, it is expected that implementation of GST will increase GDP by 2 percentage points. Along with GDP growth, adequate emphasis should also be given to the inclusive growth, equitable distribution of wealth and prosperity and rural development to achieve the goal of sustainable development in the coming times.

Given the large young population of our country, there is a huge potential for the demographic dividend. To make the best use of this dividend, government should facilitate investment in skill formation education and health sector.

Looking ahead, with some positive announcements in the key sectors in the upcoming budget and with proper and timely implementation of the expected reforms, India is poised to enter double digit growth trajectory and we expect it to grow at 10% in the medium term. We look forward to significant growth of all sectors that will refuel India's growth story in the coming times.

## Economy on the eve of Union Budget 2015-16

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Efforts put in by Mr. Hariom Kuthwaria to design this report are appreciated.

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