STATE OF THE ECONOMY 2022-23: RECOVERY COMPLETE

01

CHAPTER

In general, global economic shocks in the past were severe but spaced out in time. This changed in the third decade of this millennium. At least three shocks have hit the global economy since 2020. It all started with the pandemic-induced contraction of the global output, followed by the Russian-Ukraine conflict leading to a worldwide surge in inflation. Then, the central banks across economies led by the Federal Reserve responded with synchronised policy rate hikes to curb inflation. The rate hike by the US Fed drove capital into the US markets causing the US Dollar to appreciate against most currencies. This led to the widening of the Current Account Deficits (CAD) and increased inflationary pressures in net importing economies. The rate hike and persistent inflation also led to a lowering of the global growth forecasts for 2022 and 2023 by the IMF in its October 2022 update of the World Economic Outlook. The frailties of the Chinese economy further contributed to weakening the growth forecasts. Slowing global growth apart from monetary tightening may also lead to a financial contagion emanating from the advanced economies where the debt of the non-financial sector has risen the most since the global financial crisis. With inflation persisting in the advanced economies and the central banks hinting at further rate hikes, downside risks to the global economic outlook appear elevated.

The Indian economy, however, appears to have moved on after its encounter with the pandemic, staging a full recovery in FY22 ahead of many nations and positioning itself to ascend to the pre-pandemic growth path in FY23. Yet in the current year, India has also faced the challenge of reining in inflation that the European strife accentuated. Measures taken by the government and RBI, along with the easing of global commodity prices, have finally managed to bring retail inflation below the RBI upper tolerance target in November 2022. However, the challenge of the depreciating rupee, although better performing than most other currencies, persists with the likelihood of further increases in policy rates by the US Fed. The widening of the CAD may also continue as global commodity prices remain elevated and the growth momentum of the Indian economy remains strong. The loss of export stimulus is further possible as the slowing world growth and trade shrinks the global market size in the second half of the current year.

Despite these, agencies worldwide continue to project India as the fastest-growing major economy at 6.5-7.0 per cent in FY23. These optimistic growth forecasts stem in part from the resilience of the Indian economy seen in the rebound of private consumption seamlessly replacing the export stimuli as the leading driver of growth. The uptick in private consumption has also given a boost to production activity resulting in an increase in capacity utilisation across sectors. The rebound in consumption was engineered by the near-universal vaccination coverage overseen by the government that brought people *back to the streets to spend on contact-based services, such as restaurants, hotels, shopping malls, and cinemas, among others. The world's second-largest vaccination drive involving more than 2 billion doses also served to lift consumer sentiments that may prolong the rebound in consumption. Vaccinations have facilitated the return of migrant workers to cities to work in construction sites as the rebound in consumption spilled over into the housing market. This is evident in the housing market witnessing a significant decline in inventory overhang to 33 months in Q3 of FY23 from 42 months last year.*

The Capital Expenditure (Capex) of the central government, which increased by 63.4 per cent in the first eight months of FY23, was another growth driver of the Indian economy in the current year, crowding in the private Capex since the January-March quarter of 2022. On current trend, it appears that the full year's capital expenditure budget will be met. A sustained increase in private Capex is also imminent with the strengthening of the balance sheets of the Corporates and the consequent increase in credit financing it has been able to generate. A much-improved financial health of well-capitalised public sector banks has positioned them better to increase the credit supply. Consequently, the credit growth to the Micro, Small, and Medium Enterprises (MSME) sector has been remarkably high, over 30.6 per cent, on average during Jan-Nov 2022, supported by the extended Emergency Credit Linked Guarantee Scheme (ECLGS) of the Union government. The increase in the overall bank credit has also been influenced by the shift in borrower's funding choices from volatile bond markets, where yields have increased, and external commercial borrowings, where interest and hedging costs have increased, towards banks. If inflation declines in FY24 and if real cost of credit does not rise, then credit growth is likely to be brisk in FY24.

India's economic growth in FY23 has been principally led by private consumption and capital formation. It has helped generate employment as seen in the declining urban unemployment rate and in the faster net registration in Employee Provident Fund. Still, private capex soon needs to take up the leadership role to put job creation on a fast track. Recovery of MSMEs is proceeding apace, as is evident in the amounts of Goods and Services Tax (GST) they pay, while the Emergency Credit Linked Guarantee Scheme (ECGLS) is easing their debt servicing concerns. The Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) has been directly providing jobs in rural areas and indirectly creating opportunities for rural households to diversify their sources of income generation. Schemes like PM-Kisan and PM Garib Kalyan Yojana have helped in ensuring food security in the country, and their impact was also endorsed by the United Nations Development Programme (UNDP)[1]. The results of the National Family Health Survey (NFHS) also show improvement in rural welfare indicators from FY16 to FY20, covering aspects like gender, fertility rate, household amenities, and women empowerment.

Global growth has been projected to decline in 2023 and is expected to remain generally subdued in the following years as well. The slowing demand will likely push down global commodity prices and improve India's CAD in FY24. However, a downside risk to the Current Account Balance stems from a swift recovery driven mainly by domestic demand

1 https://www.undp.org/publications/addressing-cost-living-crisis-developing-countries-poverty-and-vulnerability-projections-and-policy-responses

and, to a lesser extent, by exports. The CAD needs to be closely monitored as the growth momentum of the current year spills over into the next. Growth is expected to be brisk in FY24 as a vigorous credit disbursal, and capital investment cycle is expected to unfold in India with the strengthening of the balance sheets of the corporate and banking sectors. Further support to economic growth will come from the expansion of public digital platforms and path-breaking measures such as PM GatiShakti, the National Logistics Policy, and the Production-Linked Incentive schemes to boost manufacturing output.

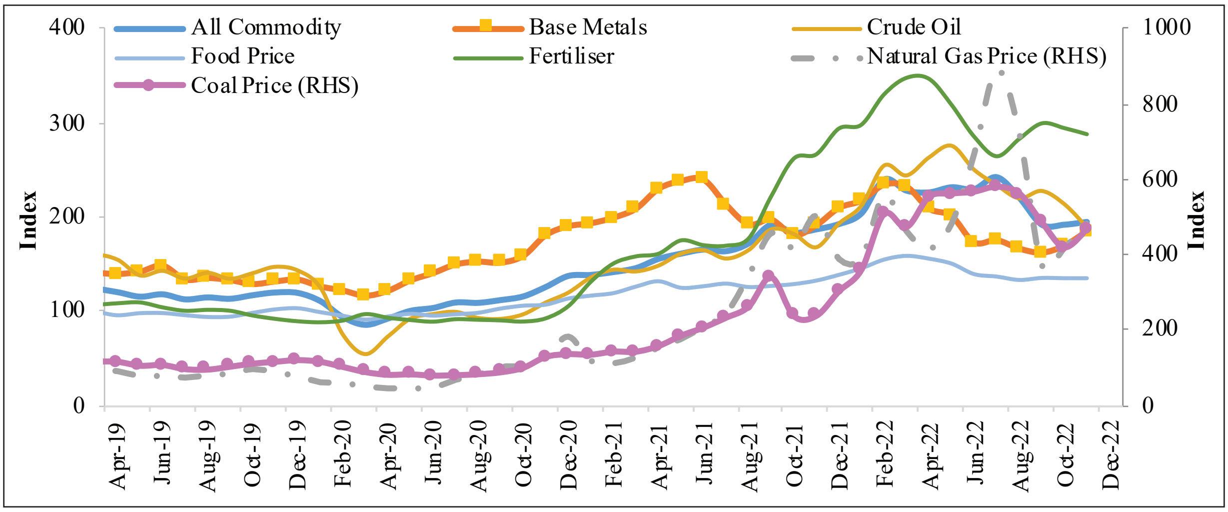
The global economy battles through a unique set of challenges

1.1 In the last century, several events can be recollected that have had an adverse impact on the global economy. The two world wars are still vivid in public memory, along with the Spanish flu and the great depression. Regional conflicts have been several, as also intermittent oil shocks. The previous millennium closed with the East Asian crisis, and the new millennium in its first decade opened with the technology bust, followed several years later by the global financial crisis. The second decade, apart from minor episodes of the taper tantrum and growing trade tensions between the super-powers, had gone relatively incident-free globally, although Europe had its moments of stress during the decade. Before the third decade of the new millennium commenced, incidents of global economic turbulence were generally spaced out, allowing economies breathing time to recover before preparing for the next challenge.

1.2 The Covid-19 pandemic ('pandemic' hereinafter) notified by the WHO in January 2020 was the first challenge of the third decade that hit global growth. Two years later, as the global economy was recovering from the pandemic-induced output contraction, the Russia-Ukraine conflict broke out in February 2022, triggering a swing in commodity prices and, thus, accelerating existing inflationary pressures. This posed the second challenge. Soon after, the third challenge emerged when nations undertook monetary tightening to rein in inflation causing growth to weaken. Monetary tightening also drove capital flows to safe-haven US markets, contributed to rising sovereign bond yields, and depreciation of most currencies against the US dollar. The consequent increase in borrowing costs also stressed high levels of public and private debt, threatening the financial system. Faced with the prospects of global stagflation, nations, feeling compelled to protect their respective economic space, slowed cross-border trade, which posed the fourth challenge to growth. All along, the fifth challenge was festering as China experienced a considerable slowdown induced by its policies. The sixth medium-term challenge to growth was seen in the scarring from the pandemic brought in by the loss of education and income-earning opportunities. A simultaneous occurrence of several challenges to growth is perhaps unprecedented. Like the rest of the world, India, too, faced this extraordinary set of challenges but withstood them better than most economies.

1.3 Global economic recovery was well on track until the Russia-Ukraine conflict broke out in February 2022. The conflict has now continued for almost a year, disrupting the restoration of the supply chains disrupted earlier by lockdowns and limited trade traffic. In the last eleven months, the world economy has faced almost as many disruptions as caused by the pandemic in two years. The conflict caused the prices of critical commodities such as crude oil, natural gas, fertilisers, and wheat to soar. This strengthened the inflationary pressures that the global economic recovery had triggered, backed by massive fiscal stimuli and ultra-accommodative monetary policies undertaken to limit the output contraction in 2020. Inflation in Advanced Economies (AEs), which accounted for most of the global fiscal expansion and monetary easing, breached historical highs. Rising commodity prices also led to higher inflation in the Emerging Market Economies (EMEs), which otherwise were in the lower inflation zone by virtue of their governments undertaking a calibrated fiscal stimulus to address output contraction in 2020.

Figure I.1: Sharp rise in commodity prices due to the Russia-Ukraine conflict; prices yet to reach pre-conflict levels



Source: IMF

Inflation stays high, driven by high food and energy prices

Figure I.2a: Advanced Economies

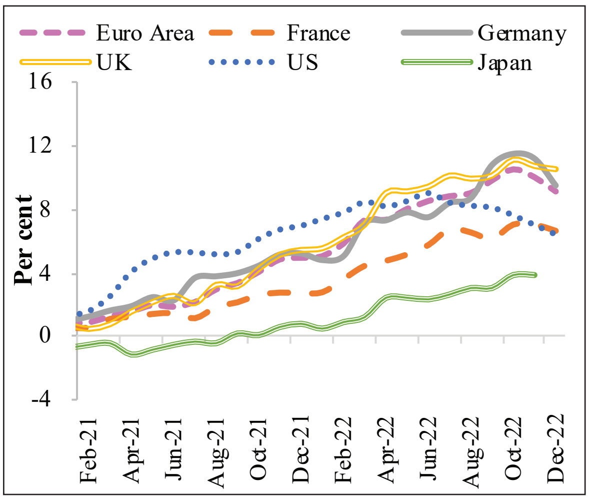
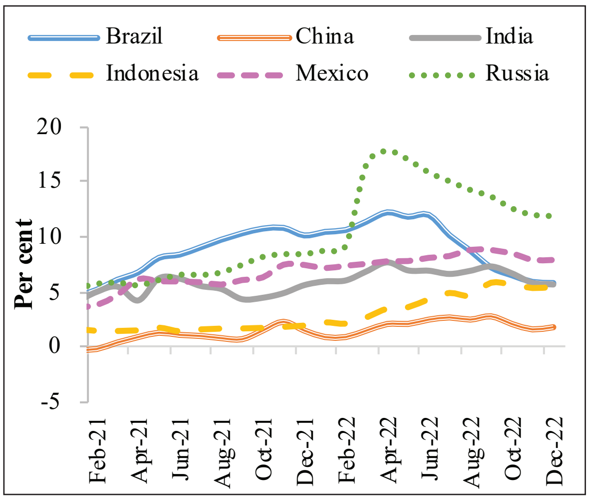


Figure I.2b: Emerging Market Economies



Source: Bloomberg

1.4 Central banks, which were slow to react to price pressures building up during the nascent recovery from the pandemic, regarded them as transient only to realise, belatedly, the necessity and the inevitability of a strong monetary policy response. Led by the US Federal Reserve, central banks have been hiking policy rates and rolling back liquidity to rein in inflation synchronously. The pace of this tightening cycle has been rapid – the Federal Reserve's pace of rate hikes is the quickest since the inflationary episode of the 1970s, with the central bank having raised interest rates by 425 basis points since March 2022. As the impact of monetary policy actions is felt with a lag, inflation rates remained stubbornly high during the early phase of the rate hike cycle but have begun to decline lately. At the same time, synchronised rate hikes by the central banks have not tightened financial conditions sufficiently enough for central banks to end their tightening campaign.

Financial Conditions tighten

Figure I.3a: Advanced Economies

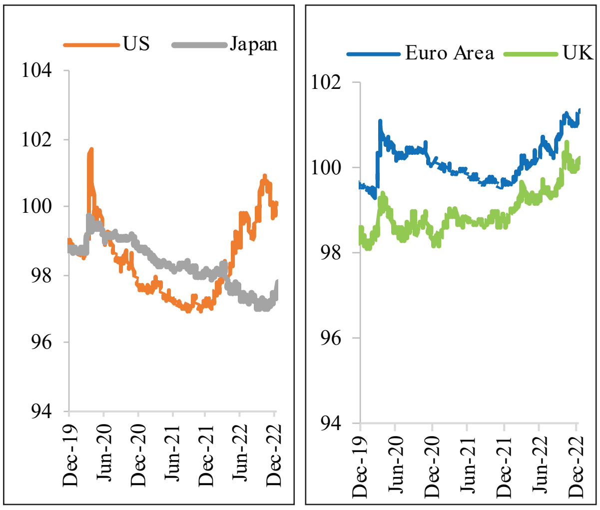
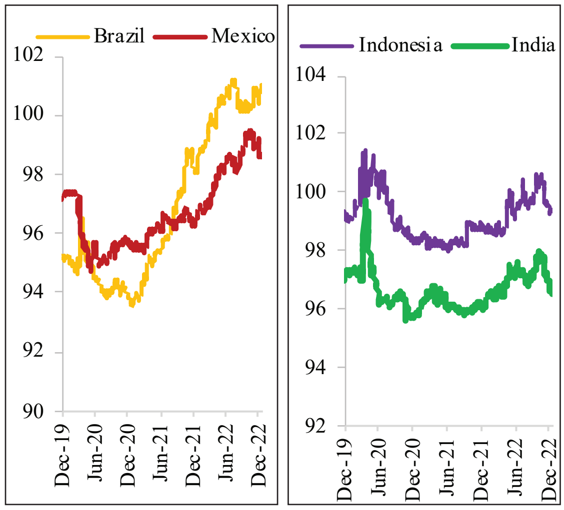


Figure I.3b: Emerging Market Economies



Source: Goldman Sachs, Bloomberg

Note: All Y-axes are indices; Data is retrieved from Goldman Sachs financial condition index

1.5 Inflation and monetary tightening led to a hardening of bond yields across economies and resulted in an outflow of equity capital from most of the economies around the world into the traditionally safe-haven market of the US. Unlike the past when the capital flight was more out of the EMEs given their relatively greater vulnerabilities, or the perception thereof, this time around, capital has also flown out from the advanced economies. The capital flight subsequently led to the strengthening of the US Dollar against other currencies – the US Dollar index strengthened by 16.1 per cent between January and September 2022. The consequent depreciation of other currencies has been widening the CAD and increasing inflationary pressures in the net importing economies.

Hardening of bond yields across economies

Figure I.4a: 10-year Bond Yield in AEs

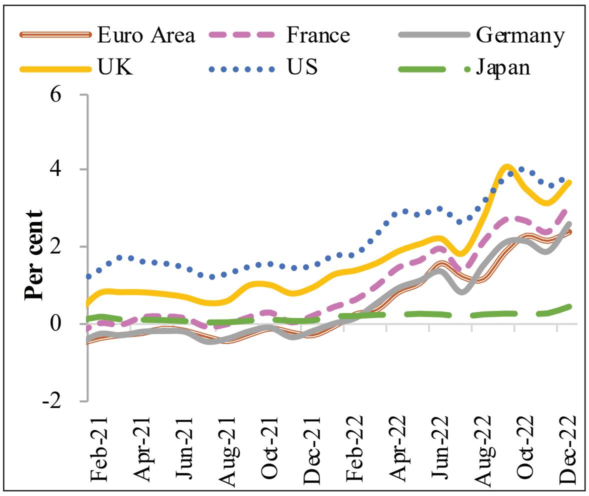
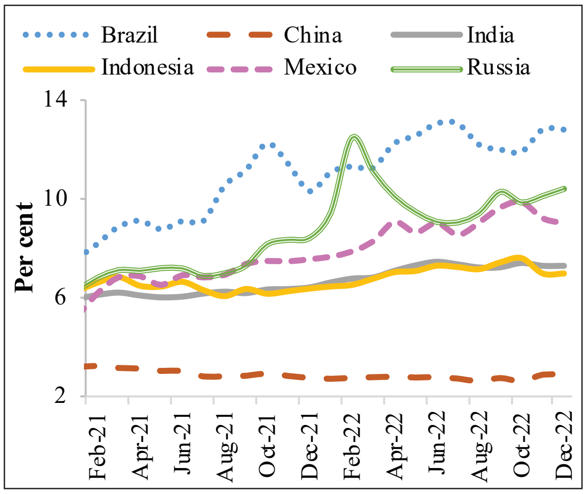
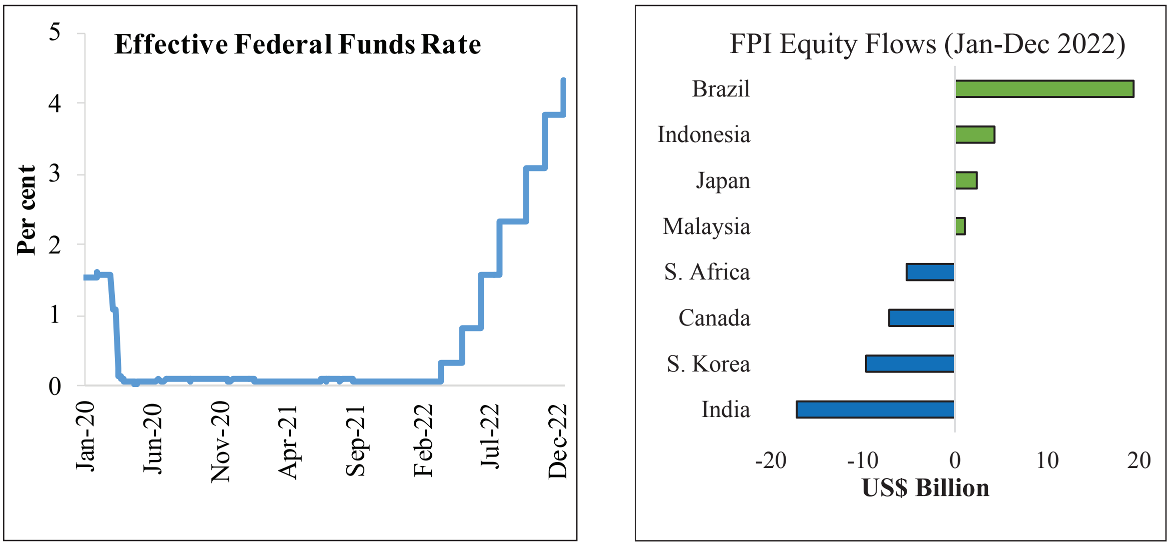


Figure I.4b: 10-year Bond Yield in EMEs



Source: Bloomberg

Figure I.5: The Federal Funds Rate was raised by a cumulative 425 basis points since Jan 2022 leading to capital flight from EMEs and AEs



Source: Federal Reserve

Source: Bloomberg

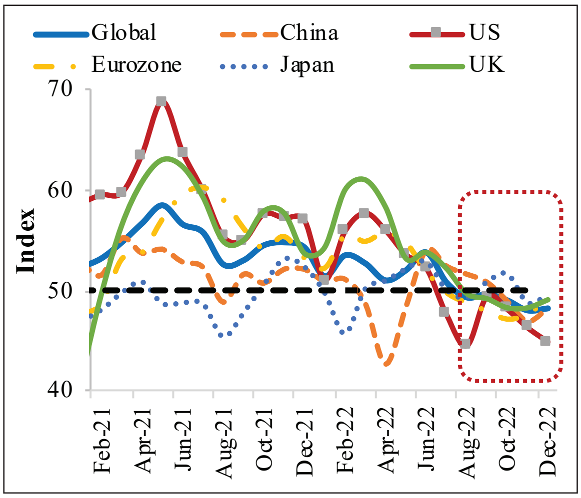
1.6 Rising inflation and monetary tightening led to a slowdown in global output beginning in the second half of 2022. The global PMI composite index has been in the contractionary zone since August 2022, while the yearly growth rates of global trade, retail sales, and industrial production have significantly declined in the second half of 2022. The consequent dampening of the global economic outlook, also compounded by expectations of a further increase in borrowing costs, was reflected in the lowering of growth forecasts by the IMF in its October 2022 update of the World Economic Outlook (WEO).

Table I.1: Global economic challenges led to a downward revision in growth forecast across countries

	Growth Projections (per cent)		Change from WEO Update (July 2022) (per cent)	
	2022	2023	2022	2023
World	3.2	2.7	0	–0.2
Advanced Economies	2.4	1.1	–0.1	–0.3
United States	1.6	1	–0.7	0
Euro Area	3.1	0.5	0.5	–0.7
UK	3.6	0.3	0.4	–0.2
Japan	1.7	1.6	0	–0.1
Emerging Market Economies	3.7	3.7	0.1	–0.2
China	3.2	4.4	–0.1	–0.2
India*	**6.8**	**6.1**	**–0.6**	**0**

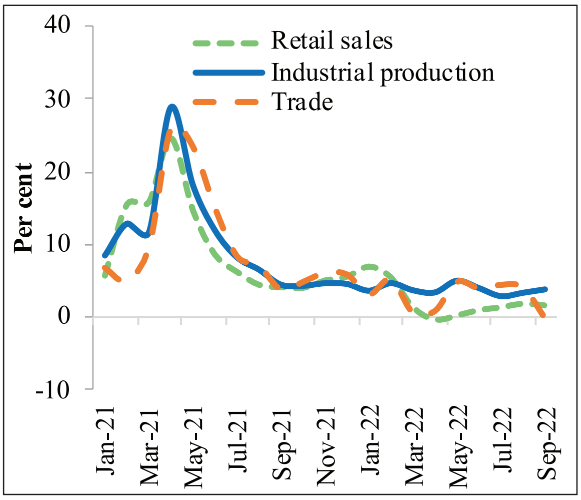
Source: IMF
Note: *Projection for India is for its fiscal year (Apr-Mar), while for the other economies, it is from Jan-Dec.

Figure I.6: Global Composite PMI in the contractionary zone since August 2022



Source: IHS Markit

Figure I.7: YoY growth in retail sales, industrial production and trade falling



Source: OECD, November 2022

1.7 Compounding the bleak global growth outlook have been the slowdown in economic activity in China caused by the government's zero Covid policy, a contracting real estate sector, and a tepid fiscal expansion. However, China has ended or relaxed most of its restrictive policies relating to Covid. It is possible that economic activity picks up in China sooner than expected. But it is too soon to tell.

Figure I.8a: China's Industrial Production Growth (YoY) declining

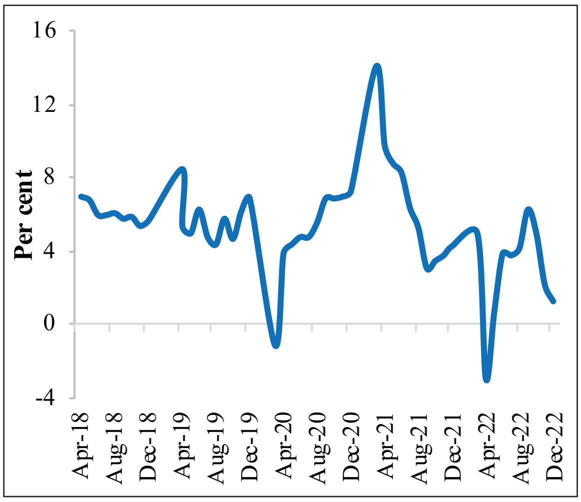
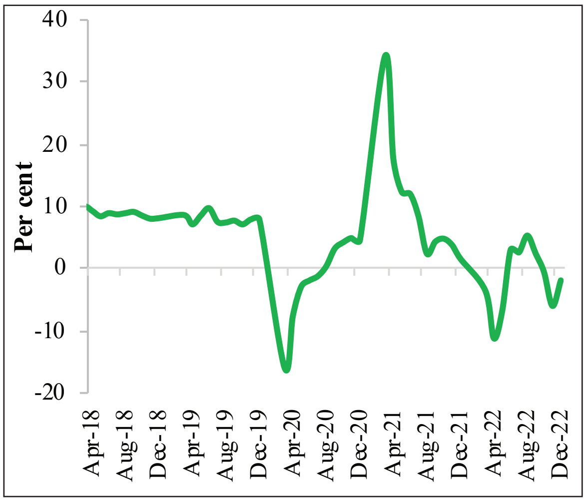


Figure I.8b: China's Retail Sales Growth (YoY) moderating



Source: Bloomberg, National Bureau of Statistics of China

1.8 Further tightening of monetary policy may aggravate fragilities built up in the financial system over the years, such as private and government debt structures, the effects of which could trigger financial contagion. Non-financial sector debt of most economies has increased considerably as a percentage of GDP since Q1 of 2008 when the global financial crisis struck. India is, however, one of the few countries whose debt burden has declined over this period, mainly because of the country's banking sector balance sheet clean-up and the corporate sector's deleveraging exercise undertaken during the last decade. Yet, an increase in the general government debt burden in India has attracted much attention, even as systemic risks of a financial breakdown are concentrated in other parts of the world.

Table I.2: Core Debt of most major economies except India is higher as compared to 2008

Core debt of the non-financial sector (Q2 2022, % of GDP)					Change since Q2 2008			
Debt/GDP (Avg %)	**Household**	**Pvt Non-Financial**	**Government**	**Total**	**Household**	**Pvt Non-Financial**	**Government**	**Total**
Global Avg	62	160	88	**248**	-4	15	27	**38**
Australia	117	181	52	**232**	7	-9	42	**33**
Brazil	35	88	91	**179**	17	-36	28	**66**
Mainland China	62	220	74	**295**	43	107	47	**155**
France	67	231	114	**345**	19	71	47	**118**
Germany	56	128	67	**195**	-4	0.4	2	**3**
India	36	88	82	**170**	-7	**-17**	16	**-7**
Italy	43	113	151	**264**	4	-4	47	**43**
Japan	69	187	238	**426**	9	29	94	**122**
South Korea	106	222	45	**268**	35	61	23	**84**
Mexico	16	40	41	**81**	3	12	20	**33**
South Africa	35	67	71	**138**	-9	-13	45	**32**

Spain	57	155	118	**273**	-26	-56	82	**26**
UK	84	150	107	**257**	-11	-28	62	**34**
US	76	155	108	**264**	-22	-15	48	**33**

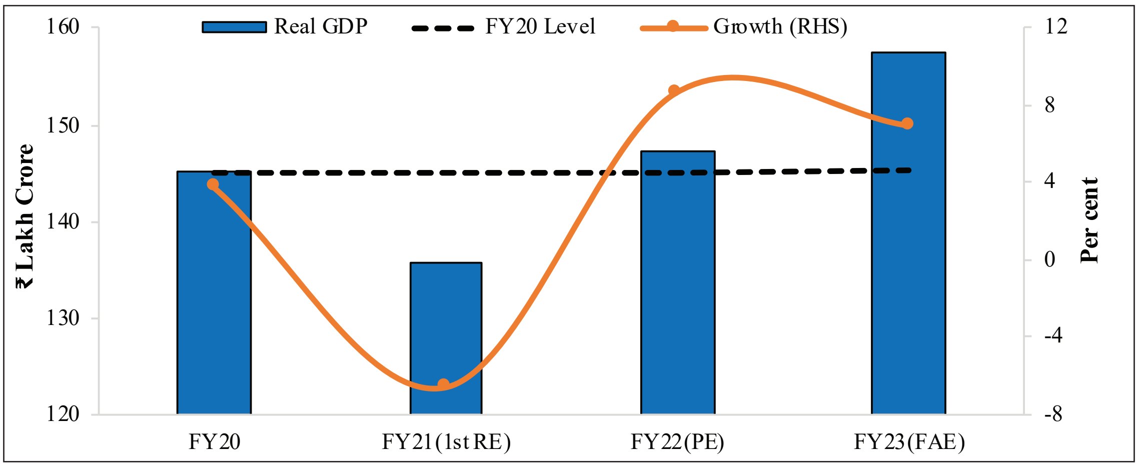
Source: BIS (based on information from their 5th December 2022 update of 'Credit to the non-financial sector')

1.9 In the developed world, inflationary pressures are abating but they are still on the higher side historically and relative to the inflation targets that many countries have adopted. Major central banks have reduced the pace of interest rate hikes in their latest rounds of monetary policy reviews to assess the impact thus far. Still, they have reiterated that terminal policy rates will be significantly higher than market expectations. Strong employment data and sharply lower headline inflation for December have raised hopes of the US economy achieving a softer landing. Similarly, in Europe, warmer winter weather has neutralised the risk of a near-term energy crisis. Lately, however, banks have reported much weaker earnings growth, and technology companies have begun to announce layoffs in America. Therefore, on balance, downside risk to the global economic outlook dominates.

Macroeconomic and Growth Challenges in the Indian Economy

1.10 The impact of the pandemic on India was seen in a significant GDP contraction in FY21. The following year, FY22, the Indian economy started to recover despite the Omicron wave of January 2022. This third wave did not affect economic activity in India as much as the previous waves of the pandemic did since its outbreak in January 2020. Mobility enabled by localised lockdowns, rapid vaccination coverage, mild symptoms and quick recovery from the virus contributed to minimising the loss of economic output in the January-March quarter of 2022. Consequently, output in FY22 went past its pre-pandemic level in FY20, with the Indian economy staging a full recovery ahead of many nations. The experience with the Omicron variant engendered a cautious optimism that it was possible to stay physically mobile and engage in economic activities despite the pandemic. FY23 thus opened with a firm belief that the pandemic was rapidly on the wane and that India was poised to grow at a fast pace and quickly ascend to the pre-pandemic growth path.

Figure I.9: Economic growth remains resilient



Source: NSO, MoSPI

Note: AE stands for Advanced Estimates, PE stands for Provisional Estimates, RE stands for Revised Estimates

Broad-based growth driven by Demand and Investment

Figure I.10a: YoY growth of Real GVA components

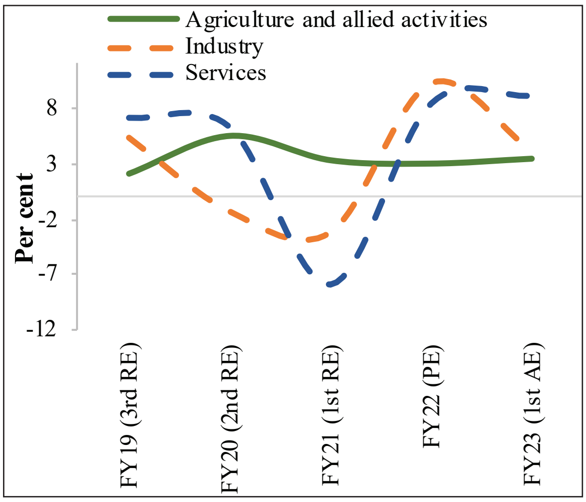
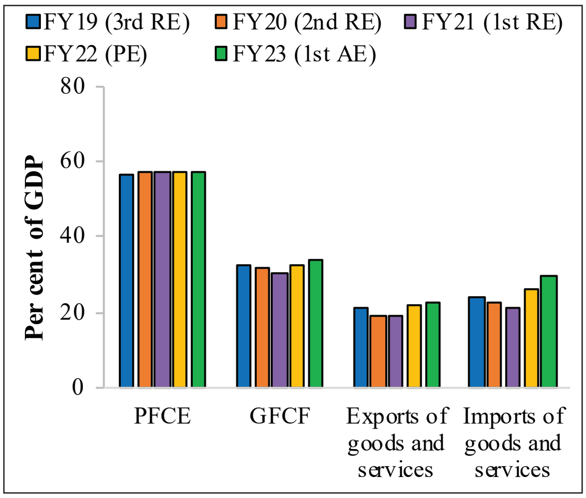
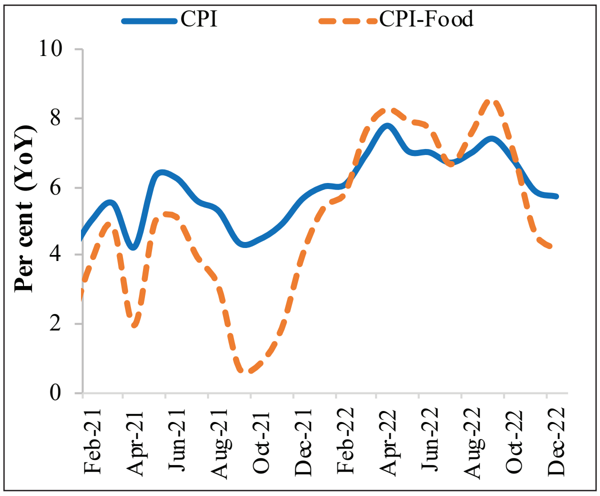


Figure I.10b: Share of Real GDP components



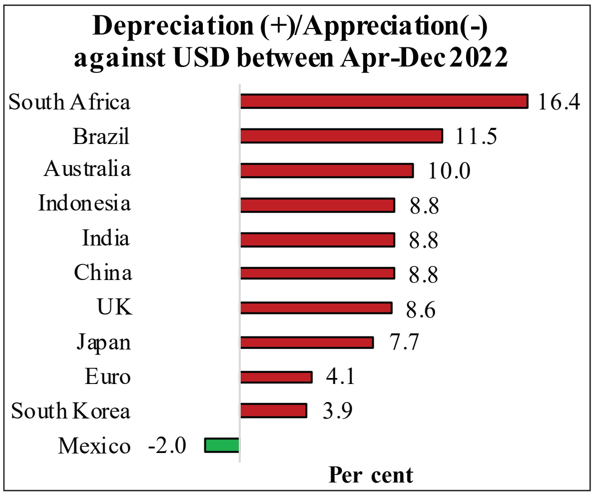
Source: NSO, MoSPI
Note: AE stands for Advanced Estimates, PE stands for Provisional Estimates, RE stands for Revised Estimates

Figure I.11: CPI Inflation eased back to RBI's target range



Source: MoSPI

Figure I.12: Indian Rupee performed well compared to other EMEs

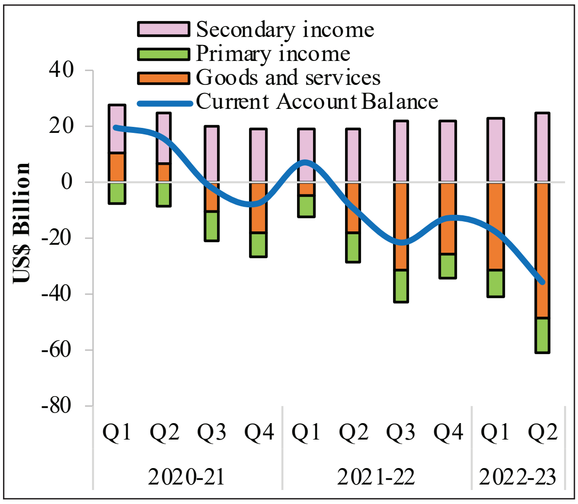


Source: Bloomberg, RBI (Exchange rates for December as on 31st Dec 2022)

1.11 However, the conflict in Europe necessitated a revision in expectations for economic growth and inflation in FY23. The country's retail inflation had crept above the RBI's tolerance range in January 2022. It remained above the target range for ten months before returning to below the upper end of the target range of 6 per cent in November 2022. During those ten months, rising international commodity prices contributed to India's retail inflation as also local weather conditions like excessive heat and unseasonal rains, which kept food prices high. The government cut excise and customs duties and restricted exports to restrain inflation while the RBI, like other central banks, raised the repo rates and rolled back excess liquidity.

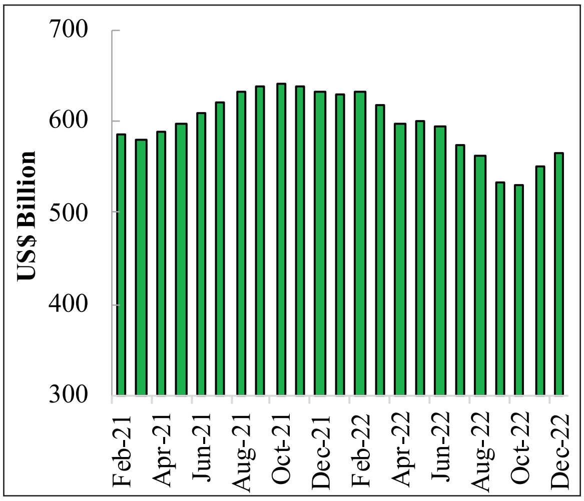
1.12 With monetary tightening, the US dollar has appreciated against several currencies, including the rupee. However, the rupee has been one of the better-performing currencies worldwide, but the modest depreciation it underwent may have added to the domestic inflationary pressures besides widening the CAD. Global commodity prices may have eased but are still higher compared to pre-conflict levels. They have further widened the CAD, already enlarged by India's growth momentum. For FY23, India has sufficient forex reserves to finance the CAD and intervene in the forex market to manage volatility in the Indian rupee.

Figure I.13: Widened Current Account Deficit



Source: RBI

Figure I.14: Adequate foreign exchange reserves to finance CAD



Source: RBI

1.13 For many countries around the world, including India, 2021 was a period of recovery for health and economies from the impact of the pandemic. For the advanced economies, in particular, the enormous fiscal stimulus earlier injected by their governments supported a strong demand revival. Growth in world trade subsequently followed, of which India was also a beneficiary. India's exports surged in FY22, and the momentum lasted up to the first half of FY23. Export growth was strong enough to increase India's share in the world market of merchandise exports. However, due to aggressive and synchronised monetary tightening, global economic growth has started to slow, and so has world trade. As per United Nations Conference on Trade and Development (UNCTAD) latest global trade update, global trade growth turned negative during the H2:2022, and geopolitical frictions, persisting inflationary pressures, and subdued demand are expected to suppress global trade further in 2023. This is likely to affect many countries, including India, with the prospects of sluggish exports continuing into FY24, compared to the promise shown at the beginning of the current year.

Figure I.15: Declining shipping freight cost as trade slows

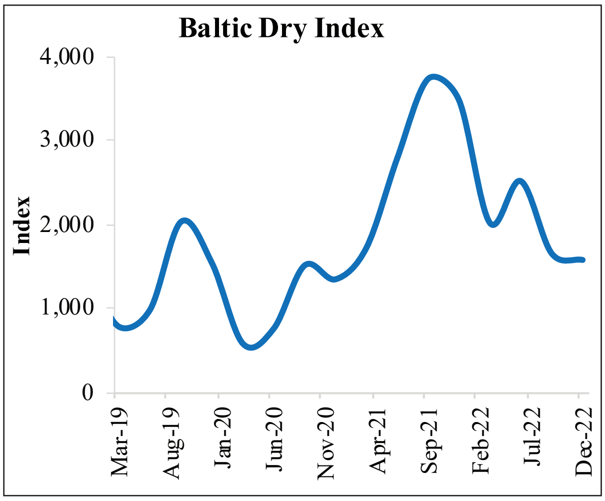
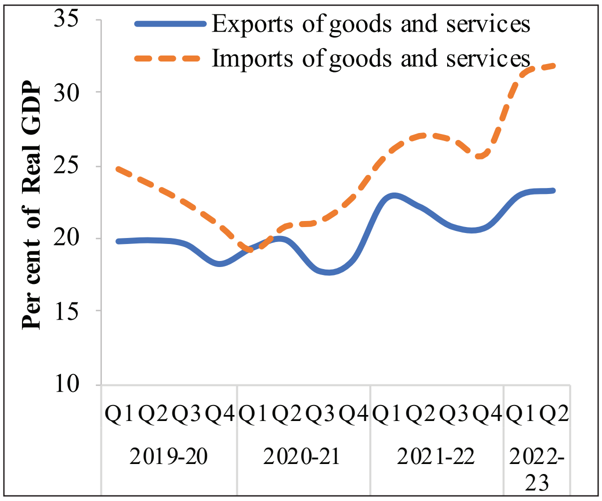


Figure I.16: Share of export in GDP expands, despite global slowdown

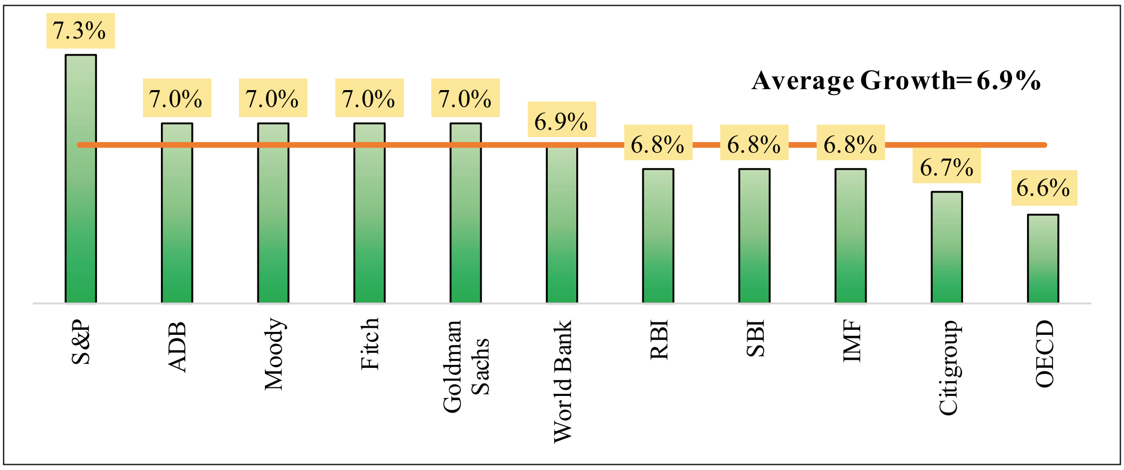


Source: The Great Eastern Shipping Co. Ltd.Source: NSO, MoSPI

India's Economic Resilience and Growth Drivers

1.14 Monetary tightening by the RBI, the widening of the CAD, and the plateauing growth of exports have essentially been the outcome of geopolitical strife in Europe. As these developments posed downside risks to the growth of the Indian economy in FY23, many agencies worldwide have been revising their growth forecast of the Indian economy downwards. These forecasts, including the advance estimates released by the NSO, now broadly lie in the range of 6.5-7.0 per cent. Despite the downward revision, the growth estimate for FY23 is higher than for almost all major economies and even slightly above the average growth of the Indian economy in the decade leading up to the pandemic. IMF estimates India to be one of the top two fast-growing significant economies in 2022. Despite strong global headwinds and tighter domestic monetary policy, if India is still expected to grow between 6.5 and 7.0 per cent, and that too without the advantage of a base effect, it is a reflection of India's underlying economic resilience; of its ability to recoup, renew and re-energise the growth drivers of the economy.

Figure I.17: India growth projections by various agencies for FY23



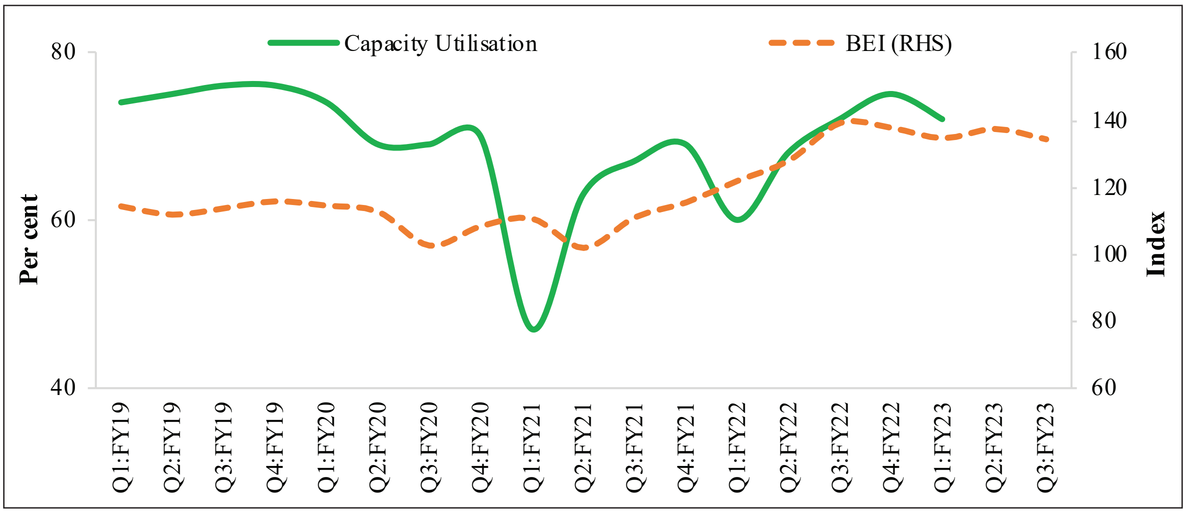
Source: Various Agencies

Note: ADB stands for Asian Development Bank, IMF is International Monetary Fund

1.15 India's economic resilience can be seen in the domestic stimulus to growth seamlessly replacing the external stimuli. The growth of exports may have moderated in the second half of FY23. However, their surge in FY22 and the first half of FY23 induced a shift in the gears of the production processes from mild acceleration to cruise mode. Manufacturing and investment activities consequently gained traction. By the time the growth of exports moderated, the rebound in domestic consumption had sufficiently matured to take forward the growth of India's economy. Private Consumption as a percentage of GDP stood at 58.4 per cent in Q2 of FY23, the highest among the second quarters of all the years since 2013-14, supported by a rebound in contact-intensive services such as trade, hotel and transport, which registered sequential growth of 16 per cent in real terms in Q2 of FY23 compared to the previous quarter.

1.16 Although domestic consumption rebounded in many economies, the rebound in India was impressive for its scale. It contributed to a rise in domestic capacity utilisation. Domestic private consumption remains buoyant in November 2022, as indicated by Motilal Oswal's Economic Activity Index. The index estimates that private consumption grew at a five-month high pace of 5.6 per cent YoY, driven by auto sales and broad-based expansion of services.[2]

Figure I.18: Enhanced capacity utilisation and business sentiments

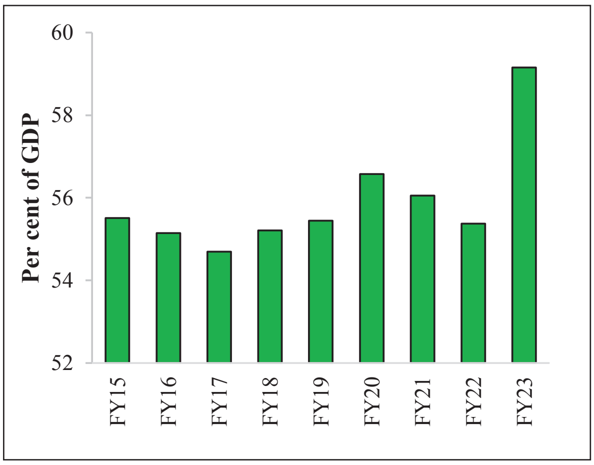


Source: RBI
Note: BEI – Business Expectations Index

1.17 The near-universal coverage of vaccination in India overseen by the government was the single most important reason that brought people out to the streets to re-experience the "bazaar" as the marketplace was rapidly populated with service providers returning to resume business. The contact-based service providers like restaurants, hotels, shopping malls, cinemas, and tourist destinations, among others, soon ran up a thriving business and have significantly contributed to keeping up the consumer sentiments, as captured in repeated surveys. If, on the one hand, the universal vaccination coverage saved lives, on the other, it served as a health stimulant to raise consumer sentiments and thus the recovery and growth of the economy.

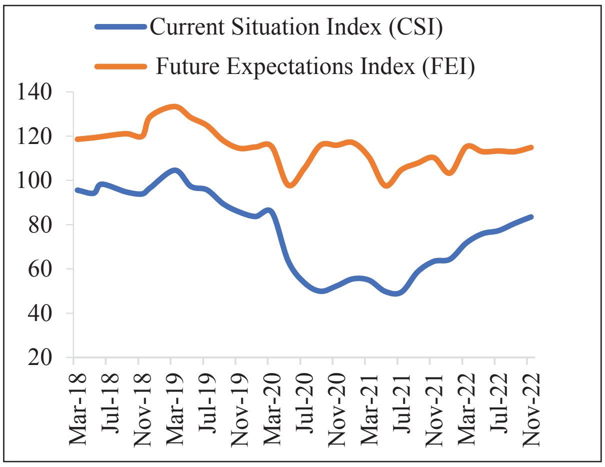
2 https://www.motilaloswal.com/site/rreports/HTML/638084191269979180/index.htm

Figure I.19A: Private consumption highest since FY15 across H1



Source: NSO, MoSPI

Figure I.19B: Improving consumer confidence

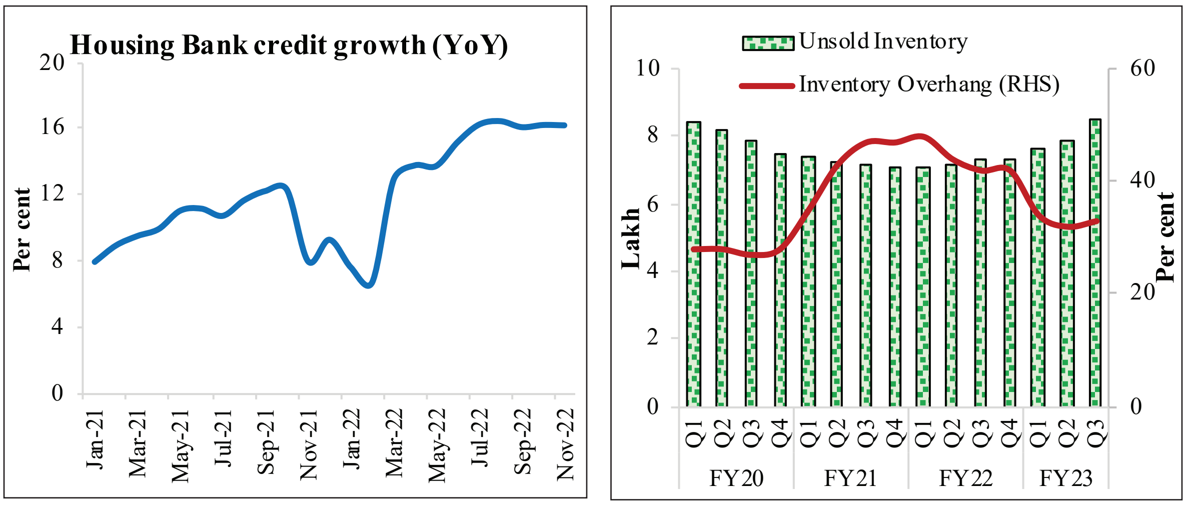


Source: RBI

1.18 The rebound in consumption has also been supported by the release of "pent-up" demand, a phenomenon not again unique to India but nonetheless exhibiting a local phenomenon influenced by a rise in the share of consumption in disposable income. Since the share of consumption in disposable income is high in India, a pandemic-induced suppression of consumption built up that much greater recoil force. Hence, the consumption rebound may have lasting power. Accelerating growth in personal loans in India testifies to an enduring release of "pent-up" demand for consumption. RBI's most recent survey[3] of consumer confidence released in December 2022 pointed to improving sentiment with respect to current and prospective employment and income conditions.

1.19 The "release of pent-up demand" was reflected in the housing market too. Demand for housing loans picked up. Consequently, housing inventories have declined, prices are firming up, and construction of new dwellings is picking up pace. This has stimulated innumerable backward and forward linkages that the construction sector is known to carry. The universalisation of vaccination coverage also has a significant role in lifting the housing market as, in its absence, the migrant workforce could not have returned to construct new dwellings.

Figure I.20: Growth in bank credit to housing complimenting falling household inventory

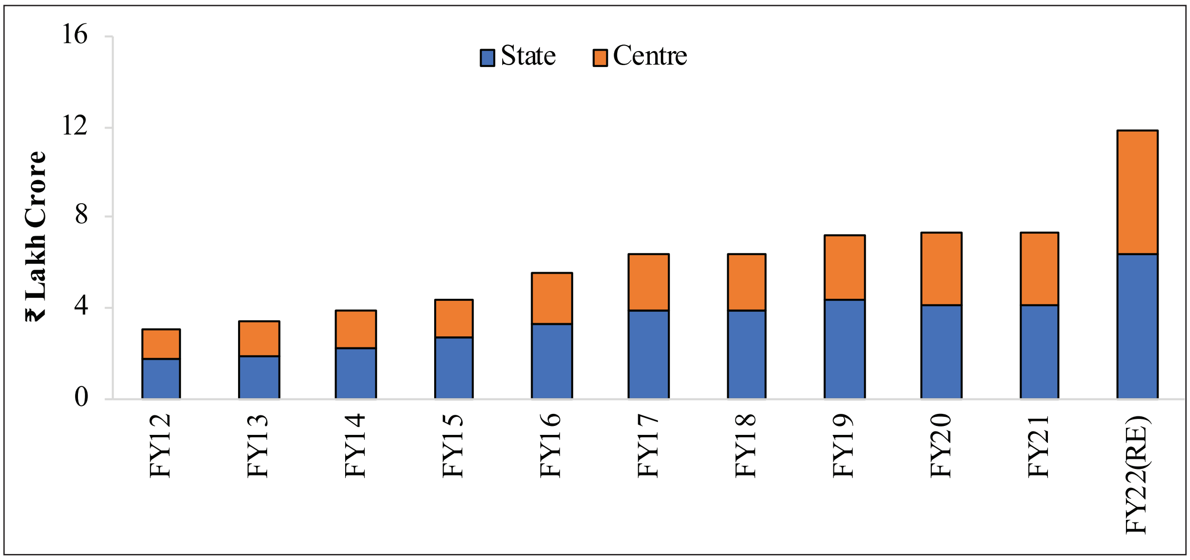


Source: RBI, PropTiger

3 See https://rbi.org.in/Scripts/PublicationsView.aspx?id=21569

1.20 Apart from housing, construction activity, in general, has significantly risen in FY23 as the much-enlarged capital budget (Capex) of the central government and its public sector enterprises is rapidly being deployed. Going by the Capex multiplier estimated for the country, the economic output of the country is set to increase by at least four times the amount of Capex.[4,5] States, in aggregate, are also performing well with their Capex plans. Like the central government, states also have a larger capital budget supported by the centre's grant-in-aid for capital works and an interest-free loan repayable over 50 years.

Figure I.21: Total capital expenditure grew at an average rate of 13.0% during FY12 and FY22

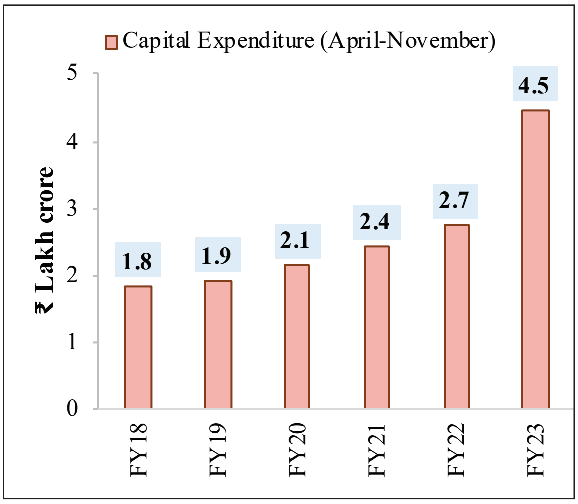


Source: Union Budget, States Budgets, RBI

1.21 A capex thrust in the last two budgets of the Government of India was not an isolated initiative meant only to address the infrastructure gaps in the country. It was part of a strategic package aimed at crowding-in private investment into an economic landscape broadened by the vacation of non-strategic PSEs (disinvestment) and idling public sector assets. Three developments support this[6]. First, the significant increase in the Capex budget in FY23, as well as its high rate of spending. Second, direct tax revenue collections have been highly buoyant, and so have GST collections, which should ensure the full expending of the Capex budget within the budgeted fiscal deficit. The growth in revenue expenditure has also been limited to pave the way for higher growth in Capex. Third, the pick-up in private sector investment since the January-March quarter of 2022. Evidence shows an increasing trend in announced projects and capex spending by the private players. Surveys of leading industry CEOs also reveal their plans and commitment to increasing Capex.

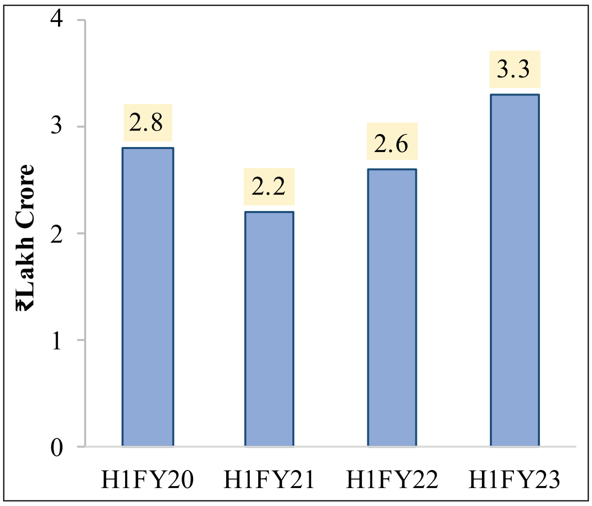
4 https://rbi.org.in/scripts/PublicationsView.aspx?Id=15369
5 https://www.nipfp.org.in/media/medialibrary/2014/02/WP_2013_125.pdf
6 https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Crowding-Out-or-Crowding-In-Public-and-Private-Investment-in-India-43470

Figure I.22: Capex doubled in the past five years



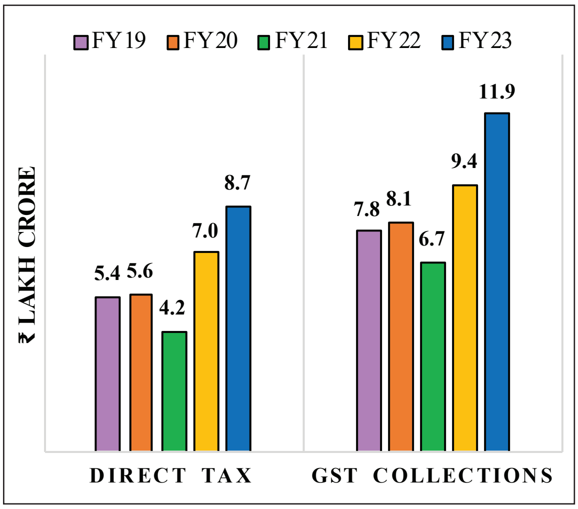
Source: CGA

Figure I.23: Private Investment remains upbeat



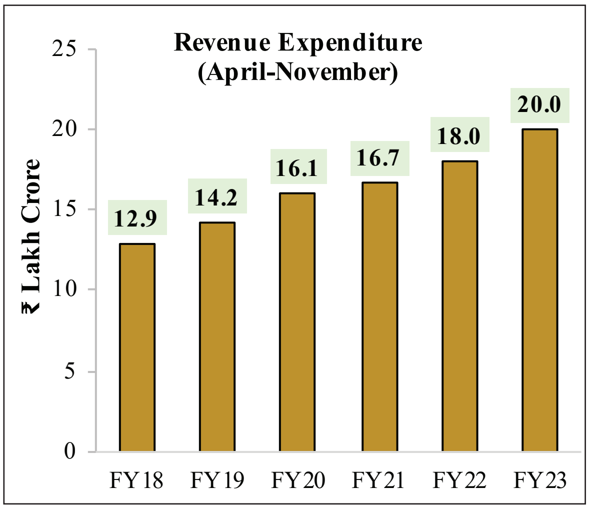
Source: Capitaline, Axis Bank Research

Figure I.24: Buoyant tax collections (April-November)



Source: CGA

Figure I.25: Limited growth in revenue expenditure

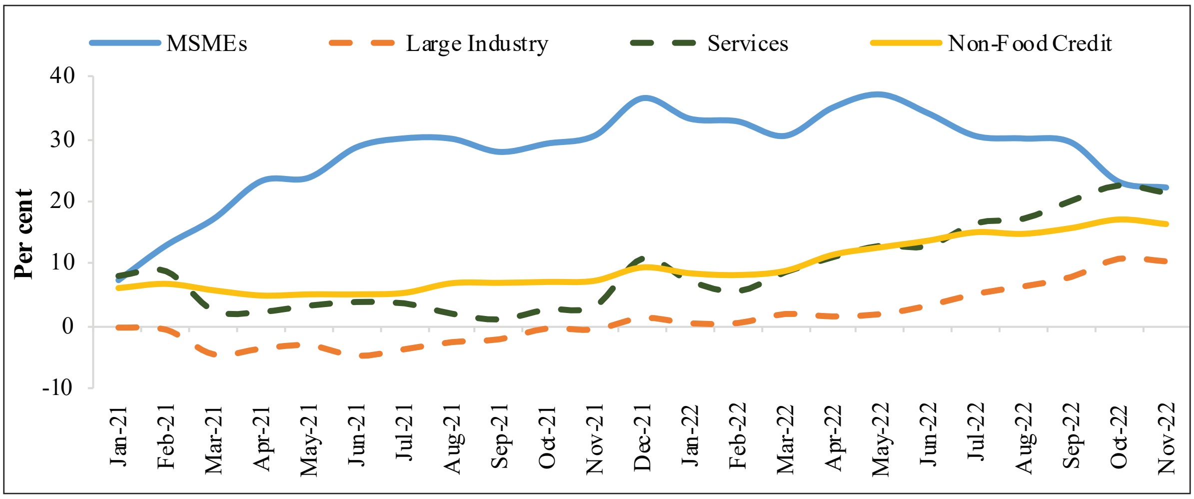


Source: CGA

1.22 While an increase in export demand, rebound in consumption, and public capex have contributed to a recovery in the investment/manufacturing activities of the corporates, their stronger balance sheets have also played a big part equal measure to realising their spending plans. As per the data on non-financial debt from the Bank for International Settlements, in the course of the last decade, Indian non-financial private sector debt and non-financial corporate debt as a share of GDP declined by nearly thirty percentage points. This limited the increase in interest costs, which, together with possible savings on overheads during lockdowns, contributed to the recent fortification of corporate balance sheets by higher profits. In FY22, the surge in exports also contributed to increasing profits in the corporate world. After-tax profits were also boosted by the lower taxes announced in 2019. Better profitability helped corporates pay down debt. Consequently, not only do corporates have more scope to borrow now, but their improved financial health has also reassured their prospective lenders to expand their credit portfolios. As per Axis Bank Business and Economic Research, Capex by the Corporate sector increased to ₹3.3 lakh crore in H1 of FY23, driven by heavy investments in electricity, steel, chemicals, auto and pharmaceuticals sectors.

1.23 The banking sector in India has responded in equal measure to the demand for credit. The Year-on-Year growth in credit since the January-March quarter of 2022 has moved into double-digits and is rising across most sectors. The credit growth to the MSME sector has been remarkably high, over 30.5 per cent, on average, during Jan-Nov 2022, supported by the extended ECLGS of the central government. The aggressive supply of credit by the banking sector has as much been triggered by their improved financial health as that of the corporates. The finances of the public sector banks have seen a significant turnaround, with profits being booked at regular intervals and their Non-Performing Assets (NPAs) being fast-tracked for quicker resolution/liquidation by the Insolvency and Bankruptcy Board of India (IBBI). At the same time, the government has been providing adequate budgetary support for keeping the PSBs well-capitalized, ensuring that their Capital Risk-Weighted Adjusted Ratio (CRAR) remains comfortably above the threshold levels of adequacy. The successful macro stress tests performed on the banking sector further testify to its financial strength. It does help that the banking sector has negligible cross-border claims in times when currency risk is high. Nonetheless, financial strength has helped banks make up for lower debt financing provided by corporate bonds and External Commercial Borrowings (ECBs) so far in FY23. Rising yields on corporate bonds and higher interest/hedging costs on ECBs have made these instruments less attractive than the previous year.

Figure I.26: Double-digit growth in Bank Credit to MSMEs



Source: RBI

Figure I.27: Declining SCB's GNPA Ratio

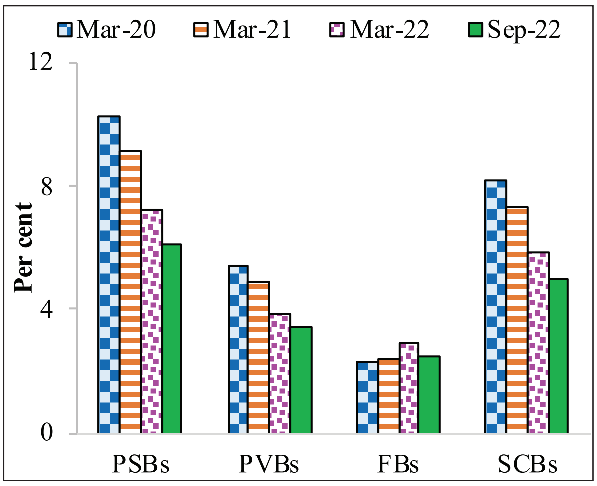
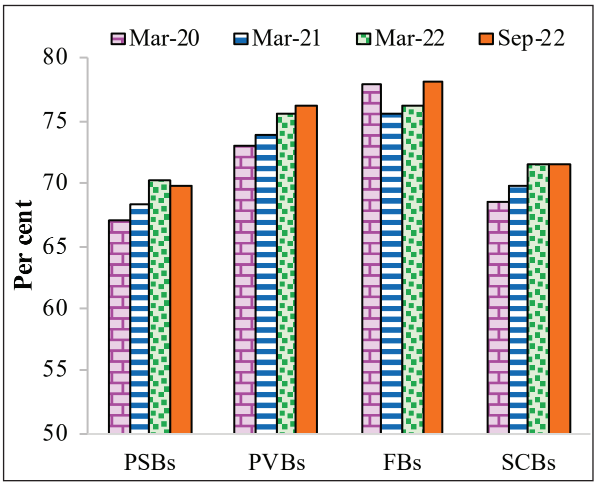


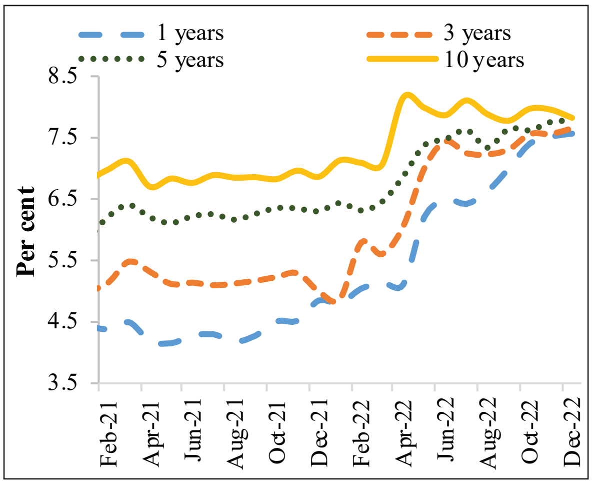
Figure I.28: Provisioning Coverage Ratio



Source: RBI

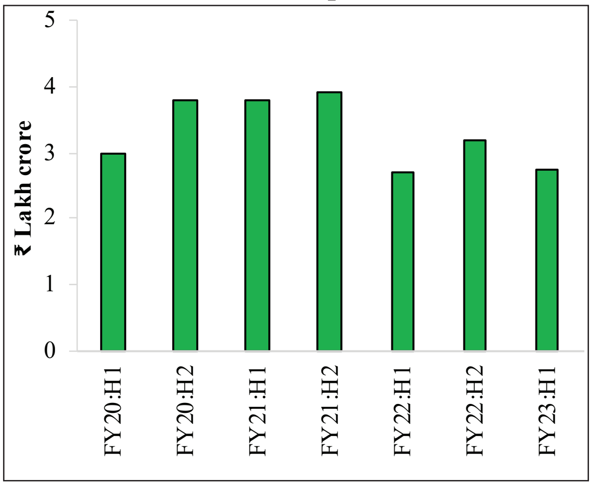
Note: SCBs stand for Scheduled Commercial Banks, PSBs stand for Public Sector Banks, PVBs stand for Private Sector Banks, FBs stands for Foreign Banks, GNPA stands for Gross Non-Performing Assets

Figure I.29: Rising Corporate Bond yields



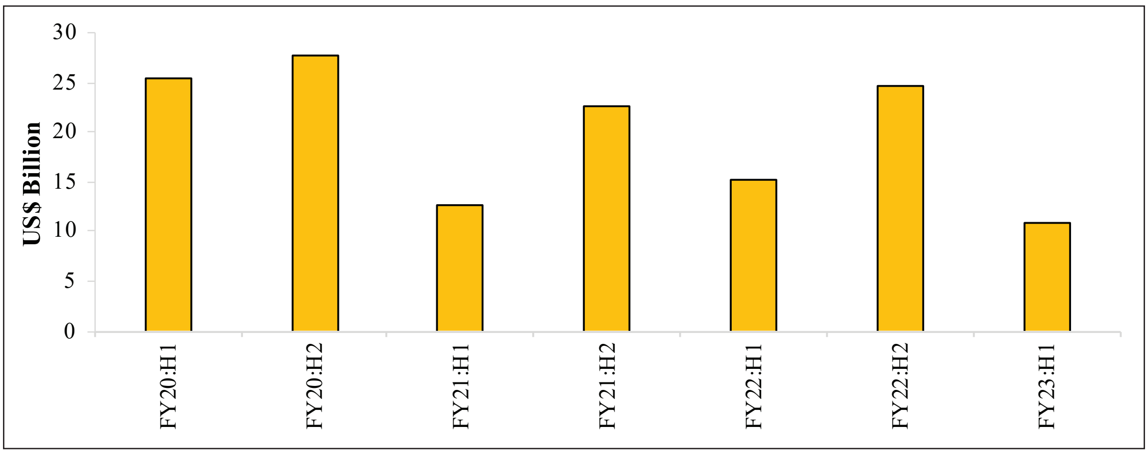
Source: Bloomberg

Figure I.30: Moderation in Private Placements of Corporate Bonds



Source: SEBI

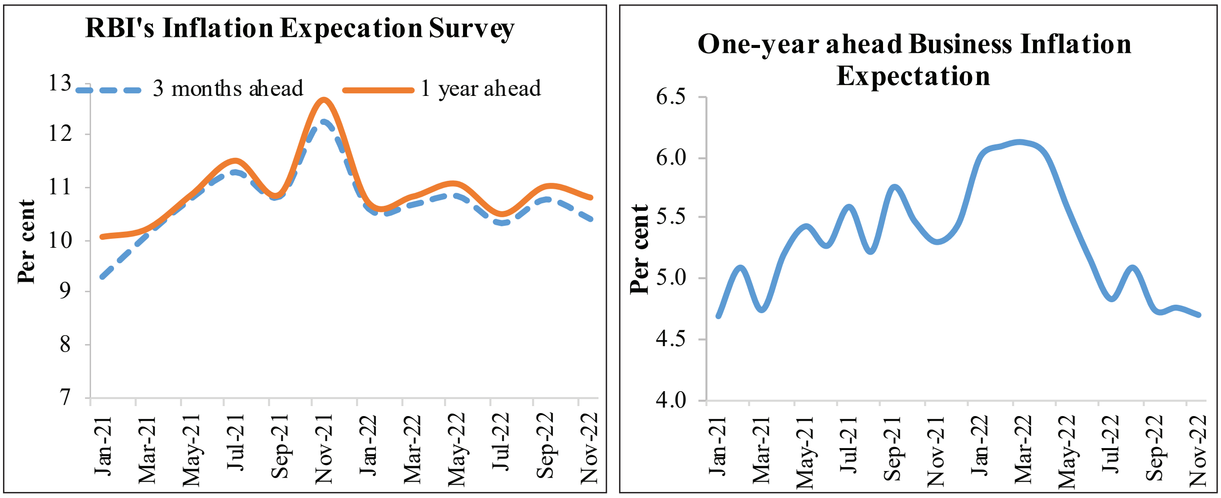
Figure I.31: Higher interest/hedging costs made ECBs and FCCBs less attractive source of funds



Source: RBI

1.24 RBI has projected headline inflation at 6.8 per cent in FY23, which is outside its target range. At the same time, it is not high enough to deter private consumption and also not so low as to weaken the inducement to invest. Moderately high inflation has further ensured the anchoring of inflationary expectations preventing prices from weakening demand and growth in India. Additionally, with inflation on the declining path, the interest cost of domestic credit will likely decline, inducing a further increase in demand for credit by corporates and retail borrowers.

Figure I.32: Inflation Expectations Anchoring



Source: RBI

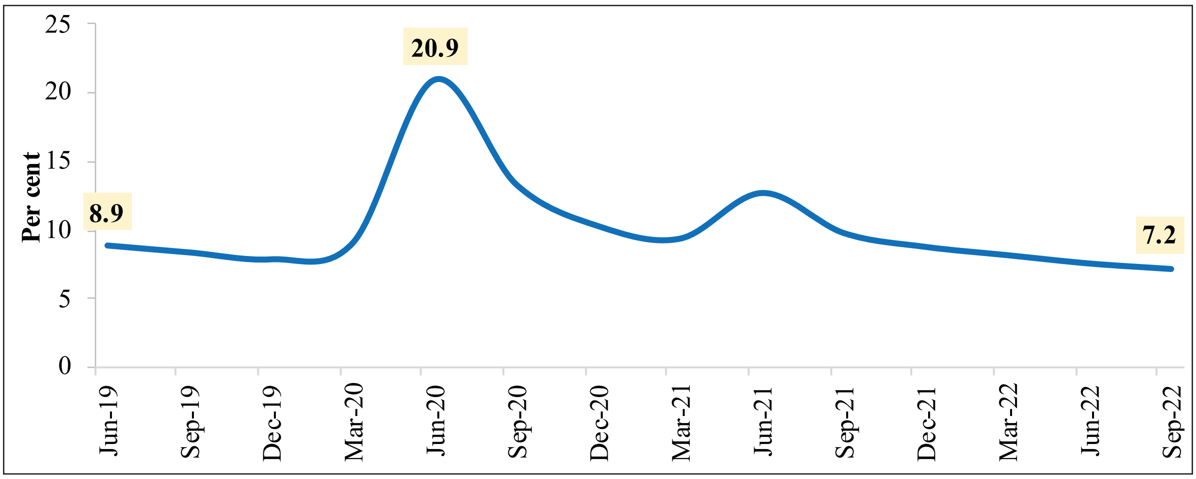
Source: IIMA

India's Inclusive Growth

1.25 Growth is inclusive when it creates jobs. Both official and unofficial sources confirm that employment levels have risen in the current financial year. The Periodic Labour Force Survey (PLFS) shows that the urban unemployment rate for people aged 15 years and above declined from 9.8 per cent in the quarter ending September 2021 to 7.2 per cent one year later (quarter ending September 2022). This is accompanied by an improvement in the labour force participation rate (LFPR) as well, confirming the emergence of the economy out of the pandemic-induced slowdown early in FY23. Job creation appears to have moved into a higher orbit with the initial surge in exports, a strong release of the "pent-up" demand, and a swift rollout of the capex. Since export growth is plateauing and the "pent-up" release of demand will have a finite life, it is essential that capex continues to grow to facilitate employment in the economy, at least until such time the global economy rebounds and, through the export channel, provides an additional window to India for job creation. Thankfully, the private sector has all the necessary pre-conditions lined up to step up to the plate and do the capex heavy lifting. Their internal resource generation is good, capacity utilisation is high, and the demand outlook continues to improve. Capital markets are willing to finance new investments, as are financial institutions.

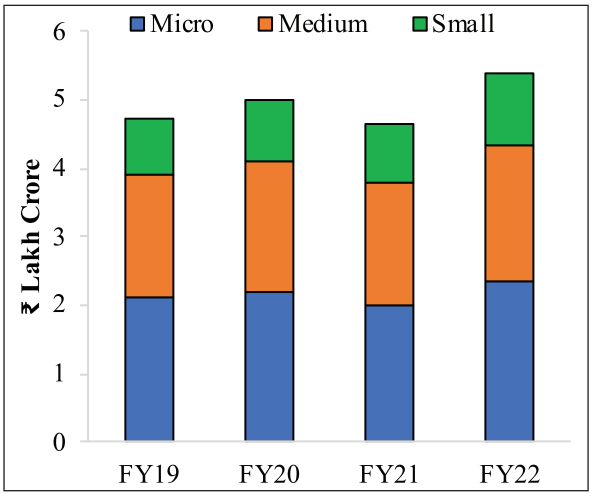
1.26 In FY21, the Government announced the Emergency Credit Line Guarantee Scheme. The scheme has succeeded in shielding micro, small and medium enterprises from financial distress. A recent CIBIL report (ECLGS Insights, August 2022) showed that the scheme has supported MSMEs in facing the covid shock, with 83 per cent of the borrowers that availed of the ECLGS being micro-enterprises. Among these micro units, more than half had an overall exposure of less than ₹10 lakh. Furthermore, CIBIL data also shows that ECLGS borrowers had lower non-performing asset rates than enterprises that were eligible for ECLGS but did not avail of it. Further, the GST paid by MSMEs after declining in FY21 has been rising since and now has crossed the pre-pandemic level of FY20, reflecting the financial resilience of small businesses and the effectiveness of the pre-emptive government intervention targeted towards MSMEs.

Figure I.33: Urban Unemployment Rate at four-year low



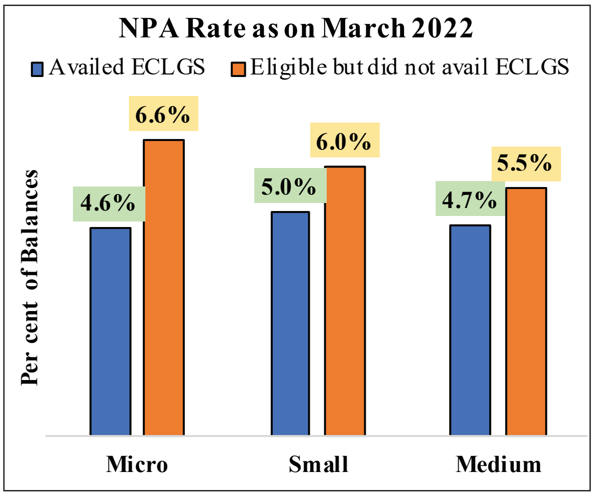
Source: NSO, MoSPI

Figure I.34: GST paid by MSMEs in FY22 crossed the pre-pandemic level



Source: Ministry of Finance
Note: Includes firms with turnover up to ₹1000 crore. Micro -- <= 25cr; Small <= 25 to 100 Cr.; Medium 100 to 1000 Cr.

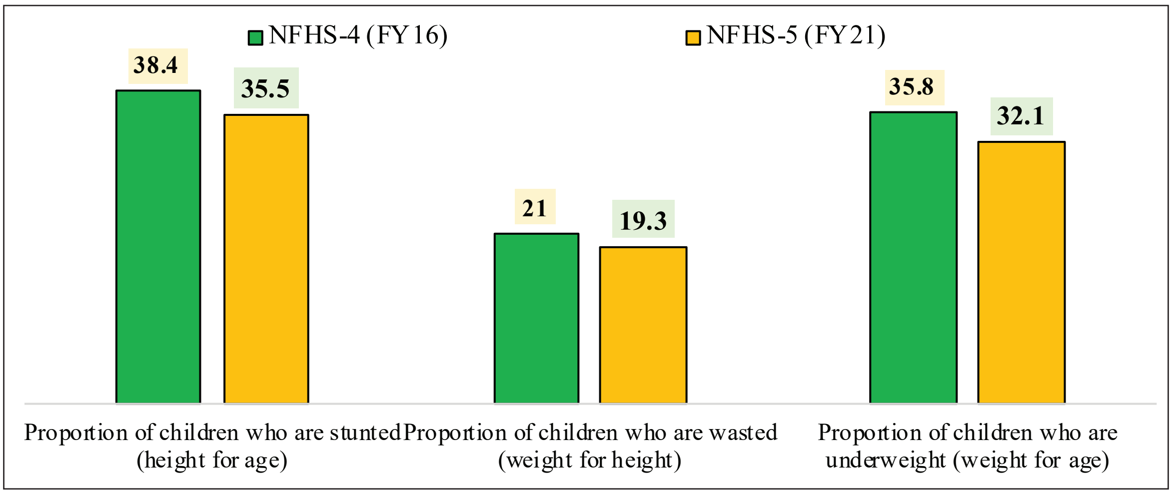
Figure I.35: ECLGS aided MSMEs in improving their asset quality



Source: ECLGS Insights Report', TransUnion CIBIL, August 2022

1.27 The scheme implemented by the government under the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) has been rapidly creating more assets in respect of "Works on individual's land" than in any other category. The share of this category rose to about 60 per cent in FY22, indicating that MGNREGA, besides generating daily wage employment, has also been creating assets for individual households to diversify their sources of income and lift their supplementary incomes. Details on asset creation under MGNREGA are further discussed in Chapters 6 "Social Infrastructure and Employment: Big Tent". In addition, schemes like PM-KISAN, which benefits households covering half the rural population, and PM Garib Kalyan Anna Yojana have significantly contributed to lessening impoverishment in the country. The UNDP Report of July 2022 stated that the recent inflationary episode in India would have a low poverty impact due to well-targeted support. In addition, the National Family Health Survey (NFHS) in India shows improved rural welfare indicators from FY16 to FY20, covering aspects like gender, fertility rate, household amenities, and women empowerment.

Figure I.36: Improvement in Rural Welfare Indicators



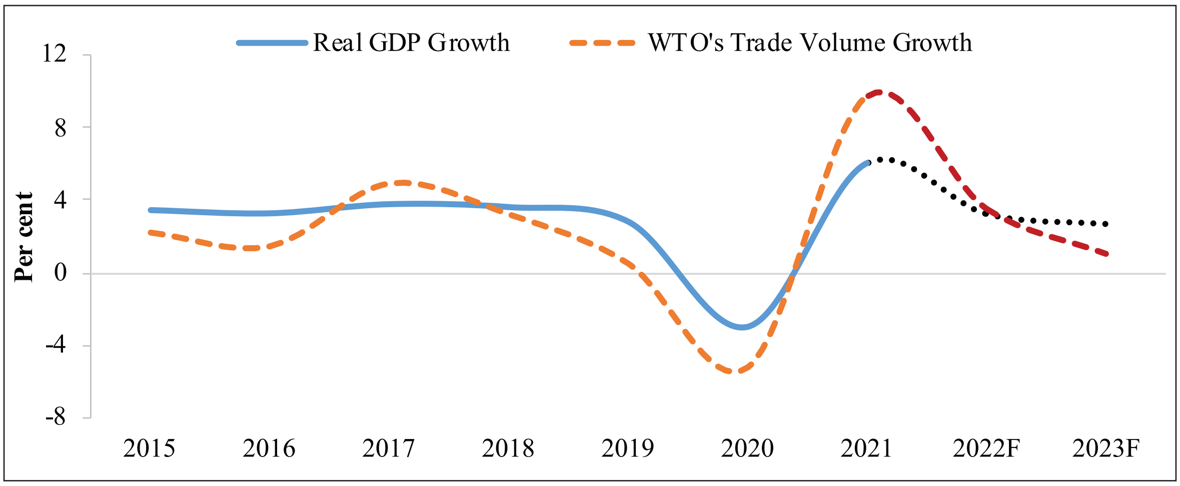
Source: NFHS-4 and NFHS-5

1.28 The year FY23 so far for India has reinforced the country's belief in its economic resilience. The economy has withstood the challenge of mitigating external imbalances caused by the Russian-Ukraine conflict without losing growth momentum in the process. India's stock markets had a positive return in CY22, unfazed by withdrawals by foreign portfolio investors. India's inflation rate did not creep too far above its tolerance range compared to several advanced nations and regions. A relatively higher growth forecast among major economies, projected retail inflation only slightly higher than the tolerance limit, and an estimated current account deficit financeable with normal capital inflows and forex reserves large enough to finance close to a year's imports are clear evidence of economic resilience amidst a global polycrisis. Strong consumption rebound, robust revenue collections, sustained capex in both the public and the private sector, growing employment levels in the urban as well as the rural areas, and targeted social security measures further underpin the prospects for economic and social stability and sustained growth. India is the third-largest economy in the world in PPP terms and the fifth-largest in market exchange rates. As expected of a nation of this size, the Indian economy in FY23 has nearly "recouped" what was lost, "renewed" what had paused, and "re-energised" what had slowed during the pandemic and since the conflict in Europe.

Outlook: 2023-24

1.29 India's recovery from the pandemic was relatively quick, and growth in the upcoming year will be supported by solid domestic demand and a pickup in capital investment. The current growth trajectory will be supported by multiple structural changes that have been implemented over the past few years. The private sector – financial and non-financial – was repairing balance sheets, which led to a slowdown in capital formation in the previous decade. The financial system stress experienced in the second decade of the millennium, evidenced by rising non-performing assets, low credit growth and declining growth rates of capital formation, caused by excessive lending witnessed in the first decade-plus, is now behind us. Aided by healthy financials, incipient signs of a new private sector capital formation cycle are visible. More importantly, compensating for the private sector's caution in capital expenditure, the government raised capital expenditure substantially. Budgeted capital expenditure rose 2.7X in the last seven years, from FY16 to FY23, re-invigorating the Capex cycle. Structural reforms such as the introduction of the Goods and Services Tax and the Insolvency and Bankruptcy Code enhanced the efficiency and transparency of the economy and ensured financial discipline and better compliance.

Figure I.37: Slowdown in global economic growth and trade



Source: IMF, WTO
Note: F stands for Forcast

1.30 Even as India's outlook remains bright, global economic prospects for the next year have been weighed down by the combination of a unique set of challenges expected to impart a few downside risks. Multi-decadal high inflation numbers have compelled central banks across the globe to tighten financial conditions. The impact of monetary tightening is beginning to show in slowing economic activity, especially in Advanced Economies. Besides this, adverse spillovers from the prolonged strains in supply chains and heightened uncertainty due to geo-political conflict have further deteriorated the global outlook. Hence, global growth is forecasted to slow from 3.2 per cent in 2022 to 2.7 per cent in 2023 as per IMF's World Economic Outlook, October 2022. A slower growth in economic output coupled with increased uncertainty will dampen trade growth. This is seen in the lower forecast for growth in global trade by the World Trade Organisation, from 3.5 per cent in 2022 to 1.0 per cent in 2023.

1.31 On the external front, risks to the current account balance stem from multiple sources. While commodity prices have retreated from record highs, they are still above pre-conflict levels. Strong domestic demand amidst high commodity prices will raise India's total import bill and contribute to unfavourable developments in the current account balance. These may be exacerbated by plateauing export growth on account of slackening global demand. Should the current account deficit widen further, the currency may come under depreciation pressure.

1.32 Another risk to the outlook originates from the ongoing monetary tightening exercise. While the pace of rate hikes has slowed, major central banks have reaffirmed their hawkish stance on inflation. Entrenched inflation may prolong the tightening cycle, and therefore, borrowing costs may stay 'higher for longer'. In such a scenario, global economy may be characterised by low growth in FY24. However, the scenario of subdued global growth presents two silver linings – oil prices will stay low, and India's CAD will be better than currently projected. The overall external situation will remain manageable.

1.33 The upside to India's growth outlook arises from (i) limited health and economic fallout for the rest of the world from the current surge in Covid-19 infections in China and, therefore, continued normalisation of supply chains; (ii) inflationary impulses from the reopening of China's economy turning out to be neither significant nor persistent; (iii) recessionary tendencies in major AEs triggering a cessation of monetary tightening and a return of capital flows to India amidst a stable domestic inflation rate below 6 per cent; and (iv) this leading to an improvement in animal spirits and providing further impetus to private sector investment.

1.34 Against this backdrop, the survey projects a baseline GDP growth of 6.5 per cent in real terms in FY24. The projection is broadly comparable to the estimates provided by multilateral agencies such as the World Bank, the IMF, and the ADB and by RBI, domestically. The actual outcome for real GDP growth will probably lie in the range of 6.0 per cent to 6.8 per cent, depending on the trajectory of economic and political developments globally.

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INDIA'S MEDIUM-TERM GROWTH OUTLOOK: WITH OPTIMISM AND HOPE

02

CHAPTER

2014-2022 is an important period in the economic history of India. The economy underwent a gamut of wide-ranging structural and governance reforms that strengthened the economy's fundamentals by enhancing its overall efficiency. With an underlying emphasis on improving the ease of living and doing business, the reforms were based on the broad principles of creating public goods, adopting trust-based governance, co-partnering with the private sector for development, and improving agricultural productivity. Under normal circumstances, reforms of such scale and relevance would have accelerated economic growth. However, largely due to the balance sheet stress caused by the credit boom in the previous years and secondarily due to the one-off global shocks that followed, key macroeconomic variables such as credit growth, capital formation, and hence economic growth were adversely impacted during this period. Further, some reforms deliver results with lagged effects as their diffusion in the economy takes time.

This situation is analogous to the period 1998-2002 when transformative reforms undertaken by the government had lagged growth returns due to temporary shocks in the economy. Once these shocks faded, the structural reforms paid growth dividends from 2003. Similarly, in the present decade, the presence of strong medium-term growth magnets gives us optimism and hope that once these global shocks of the pandemic and the spike in commodity prices in 2022 fade away, the Indian economy is well placed to grow faster in the coming decade. With improved and healthier balance sheets of the banking, non-banking and corporate sectors, a fresh credit cycle has already begun, evident from the double-digit growth in bank credit over the past months. Additionally, the economy has started benefiting from the efficiency gains resulting from greater formalisation, higher financial inclusion, and economic opportunities created by digital technology-based economic reforms. Thus, India's growth outlook seems better than in the pre-pandemic years, and the Indian economy is prepared to grow at its potential in the medium term.

Introduction

2.1 Indian economy has undergone a transformative process of New Age reforms in the last eight years. These diverse policies converge towards improving the economy's overall efficiency and lifting its potential growth. To achieve the broader policy goal of unleashing the productive potential of the economy and its people, the reforms aimed at enhancing the ease of living and doing business at the fundamental level. The use of technology, in particular digital technology, undergirds the reforms. The economic energy and positive mindset that the reforms unleashed would have led to a sharp acceleration in growth but for the balance sheet repair of the over-leveraged domestic financial sector (banking & non-banking) and the corporate sector and secondarily to the one-off global shocks that followed.

2.2 With the impetus of the persistent structural and governance reforms introduced in the country and strong macroeconomic stability, it is essential to get a handle on the medium-term growth outlook for India. Will the economy achieve and sustain a steady growth rate once the one-off shocks recede? This chapter attempts to answer this question and concludes that the chances of India growing at its potential and for the potential growth itself to be lifted are higher than it has been in the last two decades. The chapter starts with a brief discussion of the history of India's product and capital market reforms over the previous three decades. It further delves into the overarching philosophy behind the landmark reforms undertaken from 2014 to 2022 and elaborates on the shocks faced by the Indian economy during this period. It concludes with a discussion on the medium-term growth magnets for India.

Product and Capital Market Reforms

Initiation of the reforms- 1991

2.3 The macroeconomic imbalances of the late 1980s and early 1990s pushed the government towards introducing the structural reforms of 1991. The high combined deficit of the central and state governments, elevated inflationary pressures, and large and unsustainable current account deficit (CAD) led to a balance of payments crisis in the Indian economy.[1] In response to the situation, trade and investments were liberalised in 1991. Import licensing on almost all intermediate inputs and capital goods was done away with, and the entry restrictions for firms were simplified. The new policy encouraged the entry of private sector firms by ending the public sector monopoly in many sectors and initiating the automatic approval policy for FDI up to 51 per cent. The exchange rate was made flexible and allowed to depreciate as necessary to maintain competitiveness. The rupee was made fully convertible on the current account and partially on the capital account. These reforms had a positive effect on the economy. The real growth went up from an average of 5.5 per cent during the 1980s to 6.3 per cent from FY93 to FY2000. Trade liberalisation had a visible effect on external trade as the total goods and services trade to GDP rose from 17.2 per cent in 1990 to 30.6 per cent in 2000.[2]

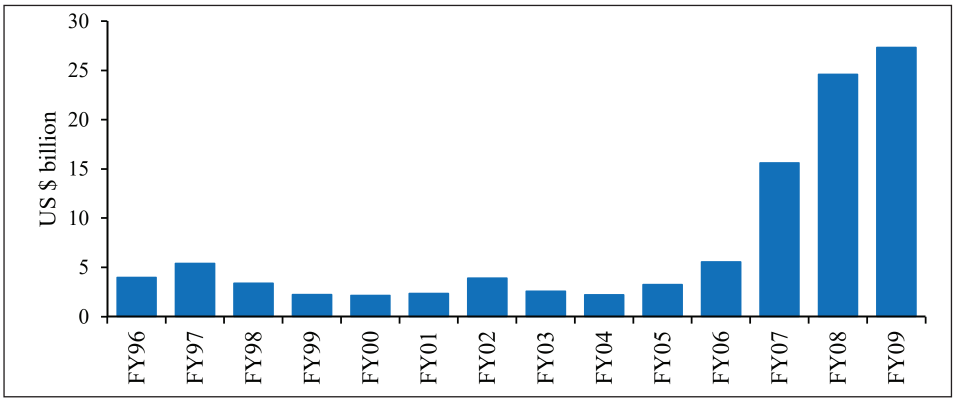
Continuity in Reforms with a Renewed Impetus

2.4 The product and capital market reforms continued slowly over the decade of the 1990s. They got a renewed impetus from the government closer to the decade's end. Investments were liberalised further to encourage Foreign Direct Investment as a main source of non-debt-creating capital inflows (Figure II.1). The telecom sector was entirely reformed by the New Telecom Policy 1999. It was opened for private sector participation with a strengthened regulatory regime (TRAI). The reforms separated the licensing and policy functions of the government from that of an operator (BSNL). These reforms were a cornerstone for the IT sector boom in India and had widespread spillover benefits to other sectors of the economy. The policy on disinvestment and privatisation also gathered steam during this period. The government set up a dedicated Ministry to take this agenda forward. It sold equity stakes in some CPSEs and privatised companies such as Maruti Udyog, Hindustan Zinc, Bharat Aluminum, and Videsh Sanchar Nigam Limited.

1 History of Reserve bank of India-Volume IV (https://www.rbi.org.in/scripts/RHvol-4.aspx)

2 Arvind Panagariya, 2004. "India in the 1980's and 1990's: A Triumph of Reforms,"IMF Working Papers2004/043, International Monetary Fund. (https://www.imf.org/external/pubs/ft/wp/2004/wp0443.pdf)

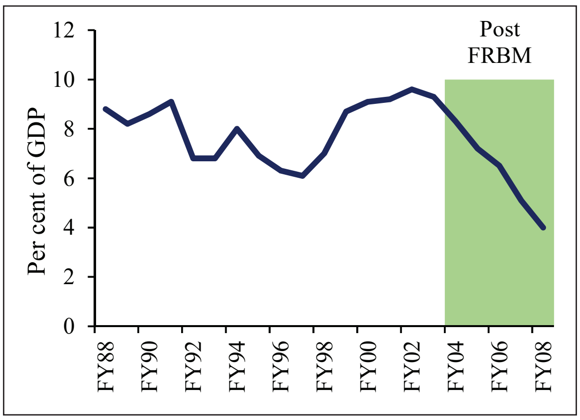
Figure II.1: Foreign Direct Investment to India- Increased after the impetus to investment liberalisation in 2000-2003



Source: RBI

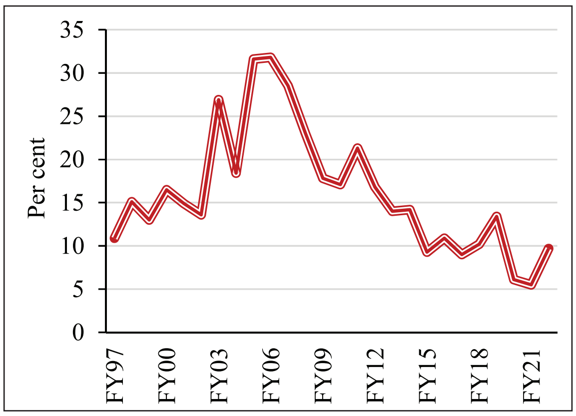
2.5 This period also marked the launch of the then largest infrastructure project of independent India, the 'Golden Quadrilateral'. The project brought significant economic benefits to the country through enhanced connectivity, improved industrial activity, trade, and economic growth.[3] Alongside this, structural policies were formulated to address the macroeconomic imbalances. The Fiscal Responsibility and Budget Management (FRBM) Act was passed to address the historic highs of the combined Gross fiscal deficit of the Government (Figure II.2). The banking system, which had accumulated bad debts during the period of economic resurgence after the 1991 reforms, was supported through the deregulation of interest rates and the enactment of the SARFAESI Act 2002. Interest rates were deregulated to promote competition amongst banks, provide more banking options to depositors, and strengthen monetary policy transmission.[4] The SARFAESI Act allowed banks and financial institutions to recover their dues by proceeding against the secured assets of the borrower/guarantor without the intervention of the court/ tribunals.[5] Both these reforms improved the credit situation in the economy (Figure II.3).

Figure II.2: Gross Fiscal Deficit (centre and states combined) (% of GDP)



Source: RBI

Figure II.3: Growth in Non-Food Credit by Scheduled Commercial Banks



Source: RBI

3 Ghani, Ejaz & Grover, Arti & Kerr, William. (2012). Highway to Success: The Impact of the Golden Quadrilateral Project for the Location and Performance of Indian Manufacturing. The Economic Journal. (https://onlinelibrary.wiley.com/doi/full/10.1111/ecoj.12207)

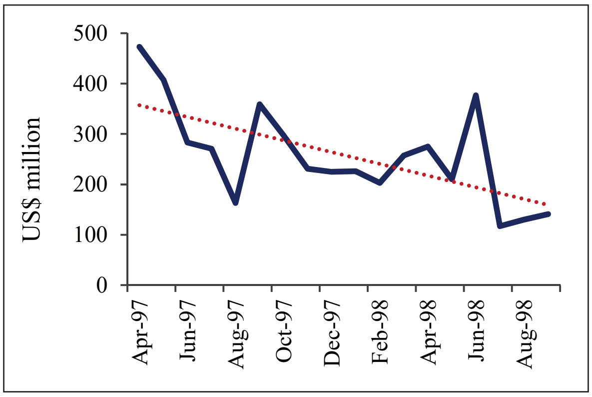
4 Reserve Bank of India RBI, 2011. "Deregulation of Savings Bank Deposit Interest Rate: A Discussion Paper,"Working Papersid:3959, eSocialSciences. (https://rbidocs.rbi.org.in/rdocs/Content/PDFs/DPS270411F.pdf)

5 Vinod Kumar, & Rajiv Khosla. (2017). IMPLEMENTATION AND IMPACT OF SARFAESI ACT 2002.International Education and Research Journal (IERJ),3(5). (http://ierj.in/journal/index.php/ierj/article/view/863/869); https://pib.gov.in/PressReleasePage.aspx?PRID=1578808

One-Off Shocks Overshadowed The Reforms of 1998-2002

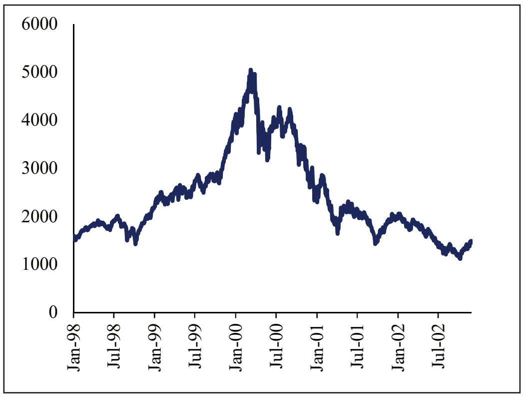
2.6 The period of these reforms also witnessed a series of domestic and global shocks, which subdued investor confidence. The sanctions imposed by the US on India after India's nuclear test led to a sharp decline in capital flows to India during the months following the nuclear tests (Figure II.4)[6]. The period between 2000 and 2002 also witnessed two successive droughts (Table II.1). These domestic shocks were accompanied by heightened global uncertainties resulting from the end of a tech boom and the 9/11 attacks (Figure II.5). Moreover, the balance sheets of the Indian financial system and corporate sector were under-repair during the period. Though all these factors overshadowed the immediate impact of reforms undertaken by the government then, they laid the groundwork and prepared the Indian economy structurally to participate in the Global boom which followed soon after.

Figure II.4: Monthly Foreign Direct Investment came down (1998)



Source: RBI

Figure II.5: Trends in the NASDAQ Composite index (Dot-Com Bubble crisis)



Source: FRED

Table II.1: Occurrence, number of people affected and damages of droughts in India between 2000 and 2002

Date	Location	Numbers
Apr 2000	Gujarat, Rajasthan, Madhya Pradesh, Andhra Pradesh, Orissa, Maharashtra	Affected- 9 crore; Damage-US$588,000,000
Nov 2000	Mahasamund, Raipur, Kawardha, Rajnandgaon, Durg districts (Chhattisgarh region)	
May 2001	New Delhi, Rajasthan, Gujarat, Orissa	20 deaths
Jul 2002	Uttar Pradesh, Madhya Pradesh, Rajasthan, Punjab, Haryana, Delhi, Karnataka, Kerala, Nagaland, Orissa, Chhattisgarh, Himachal Pradesh, Gujarat, Maharashtra, Andhra Pradesh, Tamil Nadu	Affected-30 crore; Damage- US$910,721,000

Source: Samra, J. S., 2004. "Review and analysis of drought monitoring, declaration and management in India,"IWMI Working PapersH035617, International Water Management Institute. (https://www.preventionweb.net/files/1868_VL102135.pdf)

6 Daniel Morrow & Michael Carriere (1999) The economic impacts of the 1998 sanctions on India and Pakistan, The Nonproliferation Review, 6:4,1-16. (https://www.nonproliferation.org/wp-content/uploads/npr/morrow64.pdf)

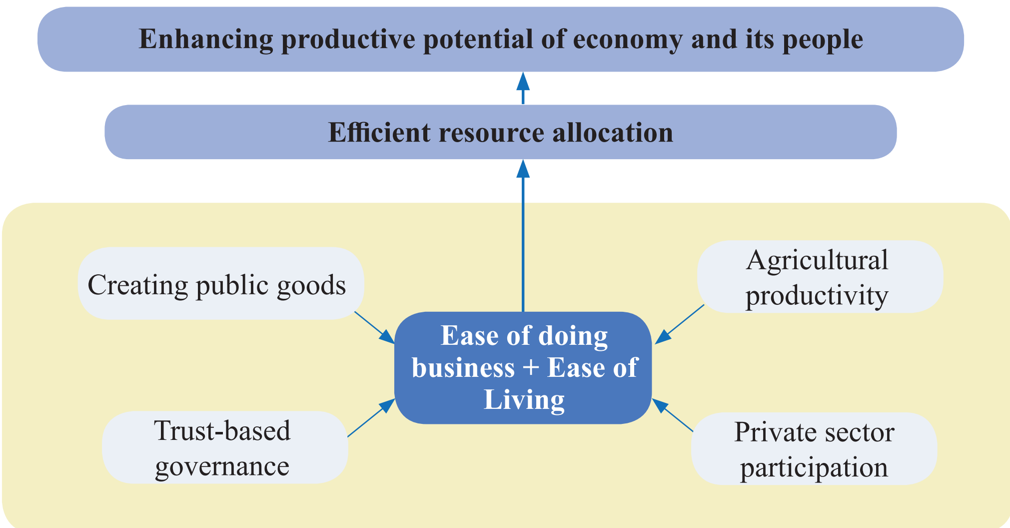
India's Participation in The Global Boom of 2003-08

2.7 The growth dividends from the reforms of 1998-2002 were realised once these one-off shocks dissipated. The years of structural reforms had prepared the Indian economy to contribute to global growth and also benefit from it. While the global growth averaged 4.8 per cent during 2003-2008, the Indian economy grew at more than 8 per cent on average. The economic growth during the period was supported by strong capital inflows (Figure II.1), which indicated favourable domestic and external factors. Some of these included sustained momentum in domestic economic activity, better corporate performance, a conducive investment climate, positive sentiments for India as a preferred investment destination, and encouraging global liquidity conditions/ interest rates.[7] This combination of structural economic reforms with their lagged effect on economic growth has parallels to what is unfolding in the Indian economy presently.

Reforms for New India-Sabka Saath Sabka Vikaas

2.8 The reforms undertaken before 2014 primarily catered to product and capital market space. They were necessary and continued post-2014 as well. The government, however, imparted a new dimension to these reforms in the last eight years. With an underlying emphasis on enhancing the ease of living and doing business and improving economic efficiency, the reforms are well placed to lift the economy's potential growth. The broad principles behind the reforms were creating public goods, adopting trust-based governance, co-partnering with the private sector for development, and improving agricultural productivity (Figure II.6). This approach reflects a paradigm shift in the growth and development strategy of the government, with the emphasis shifted towards building partnerships amongst various stakeholders in the development process, where each contributes to and reaps the development benefits (*Sabka Saath, Sabka Vikaas*).

Figure II.6: Underlying framework for Reforms for a new India



2.9 While the reforms undertaken in the post-2014 period have multiple socioeconomic benefits for the economy, this chapter focuses on the growth-centric aspects of these reforms.

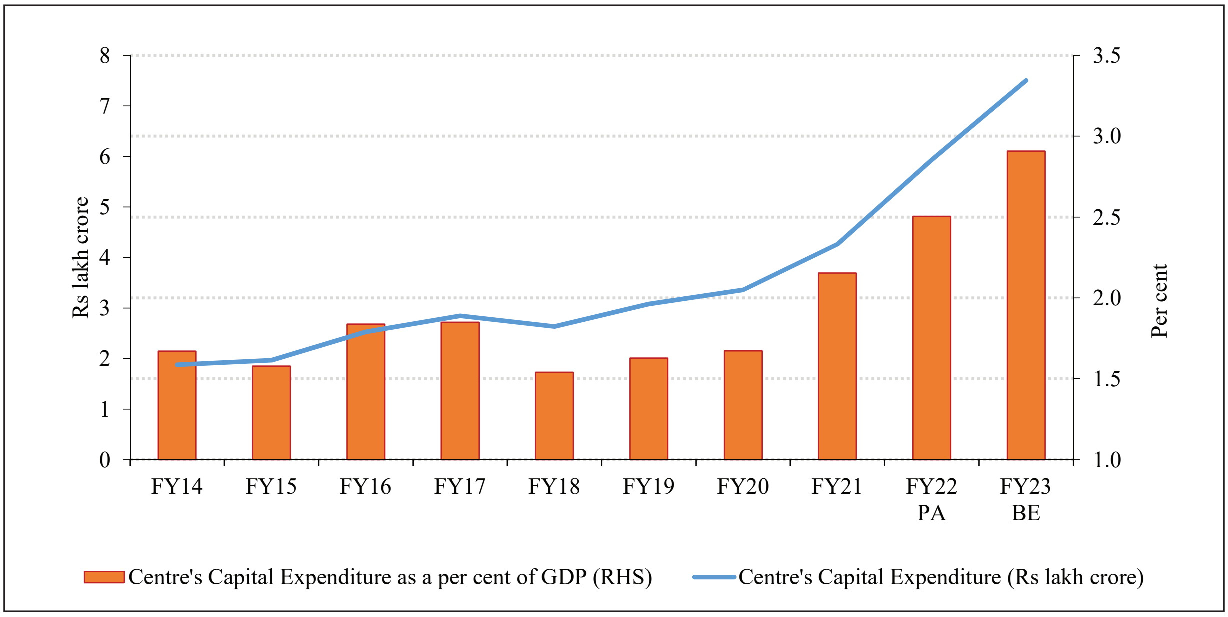
7 Mohan, Rakesh, (2008), Capital flows to India, p. 235-263 in Settlements, Bank for International eds., Financial globalisation and emerging market capital flows, vol. 44, Bank for International Settlements, (https://www.bis.org/publ/bppdf/bispap44m.pdf)

The forthcoming section discusses how each of the principles that anchor the new reform framework contributes to enhancing the productive potential of the economy and its people. These have more profound positive implications for India's medium-term growth outlook.

I. Creating public goods to enhance opportunities, efficiencies and ease of living

2.10 The launch of the Golden Quadrilateral project in the 2000s was the beginning of infrastructure-intensive policymaking in India, which continued sedately for another decade. A quantum leap in policy commitment and outlay for infrastructure is now visible in the last few years (Figure II.7), cushioning economic growth when the non-financial corporate sector was unable to invest due to balance sheet troubles. In doing so, the government has laid a good platform for crowding in private investments and growth in the coming decade. [8]

Figure: II.7: Union government's capital expenditure as a per cent of GDP on the rise



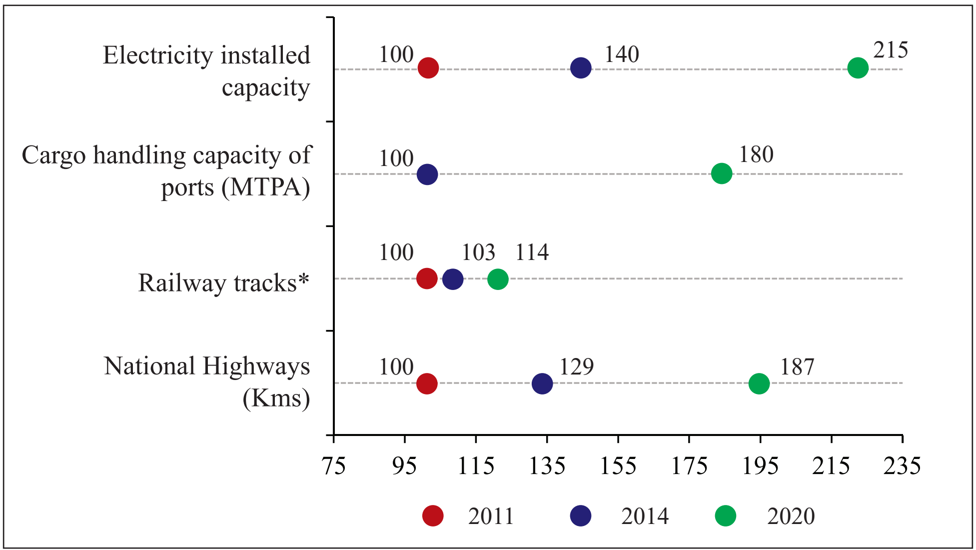
Source: RBI, MoSPI, O/o CGA

2.11 The dedicated programs for road connectivity (Bharatmala), port infrastructure (Sagarmala), electrification, railways upgradation, and operationalising new airports/ air routes (UDAN) have significantly improved the physical infrastructure in the last few years (Figure II.8). The details on the upgradation of physical infrastructure may be seen in Chapter 12. With the National Infrastructure Pipeline (NIP) in 2019 and the National Monetization Pipeline in 2021, a strong baseline for infrastructure creation and development has been put in place, providing a multitude of opportunities for foreign investment and engagement. The NIP was launched with 6,835 infrastructure projects with a projected infrastructure investment of ₹111 lakh crore. This has expanded to over 9,000 projects across 35 sub-sectors and covers economic and social infrastructure projects jointly funded by the Central Government, State Governments, and the private sector. With its strong forward and backward linkages, physical infrastructure will enhance the economy's productivity in the medium term.

8 'Crowding-Out or Crowding-In? Public and Private Investment in India', IMF Working Paper (WP/15/264), December 2015 (https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Crowding-Out-or-Crowding-In-Public-and-Private-Investment-in-India-43470)

Figure II.8: Developments in critical Infrastructure Capacity

(Values are as an index with the first available value as 100)



Source: RBI Report on Currency and Finance 2022

Note: (a) Railway tracks denote Running Track Kilometres

(b): The data for national highways for 2019 is the latest available data and is shown against 2020

2.12 Besides the push to physical infrastructure, the government's emphasis on developing public digital infrastructure during the last few years has been a game changer in enhancing the economic potential of individuals and businesses. A recently published article[9] in the RBI's Monthly Bulletin estimates that India's core digital economy has grown at 2.4 times the overall economic growth between 2014 and 2019. With its strong forward linkages to the non-digital sectors, digitalisation strengthens potential economic growth through various channels. Some of these, such as higher financial inclusion, greater formalisation, increased efficiencies and enhanced opportunities, are discussed below.

2.13 Based on the pillars of a digital identity Aadhar, linking bank accounts with PM-Jan Dhan Yojana, and the penetration of mobile phones (JAM Trinity), the country has witnessed significant progress in financial inclusion in recent years. The population covered with bank accounts increased from 53 per cent in 2015-16 to 78 per cent in 2019-21 (as per NFHS). International evidence shows that countries at the same level of development have taken almost half a century to achieve the extent of India's massive expansion in access to bank accounts (D'Silva et al. 2019)[10]. Numerous digital public goods such as digital verification (e-KYC), digital signature, digital repositories (Digilocker), and digital payments (UPI) have supported financial inclusion by improving access to formal financial services and reducing transaction costs. [11] Greater financial inclusion and access to credit incentivise higher consumption and investment, leading to higher economic growth. Some of the recently introduced digital initiatives, such as the Open Network for Digital Commerce (ONDC) and Account Aggregator framework, will open up further avenues for e-commerce market access and credit availability for smaller businesses and strengthen the expected economic growth in the medium term.

9 Dhirendra Gajbhiye et al. (2022), 'Measuring India's Digital Economy', RBI Monthly Bulletin December 2022 (https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/05ART201220221265B8E871824B98970F03E87228C0FE.PDF)

10 D'Silva, Derryl and Filková, Zuzana and Packer, Frank and Tiwari, Siddharth, The Design of Digital Financial Infrastructure: Lessons from India (December 15, 2019). BIS Paper No. 106 (https://www.bis.org/publ/bppdf/bispap106.pdf)

11 Swallow,Haksar, And Patnam (2021), Stacking Up Financial Inclusion Gains In India, IMF Finance & development (https://www.imf.org/external/pubs/ft/fandd/2021/07/india-stack-financial-access-and-digital-inclusion.htm)

2.14 Another vital contribution of digital infrastructure has been the greater formalisation of the economy. A report in The Economist (January 2023) attributes the trends of formalisation of the workforce in India to the transformed digital financial architecture, the digitalised GST system and growth in the usage of UPI.[12] The creation of digital identities such as Aadhar, registration of unorganised workers on the eshram portal, street vendors on SVANidhi, taxpaying firms on GSTN, and MSMEs on the Udayam portal, has played a significant role in the inclusion of these groups under the formal economic net. As an illustration, we can now track that out of the 1.27 crore enterprises registered on the Udyam Portal, more than 93,000 micro-enterprises have grown to become small enterprises, and 10,000 small enterprises have become medium enterprises over the last two years. [13] Creating an identity has also simplified and enabled access to formal credit for many of these groups. More than 32.7 lakh street vendors have availed of a first loan of ₹10,000 under the PM SVANidhi Scheme, and of these, more than 6.9 lakh have availed a second loan of ₹20,000. Moreover, digital systems such as the Goods and Services Tax Network (GSTN) and e-Way Bill system have enabled the formalisation of business transactions. The increasing number of GST taxpayers, from 70 lakh in 2017[14] to more than 1.4 crore in 2022, indicates the expansion in formal businesses. Formalisation of transactions, for even the smallest of amounts, has been possible with the wide usage of the digital payment system of UPI. The greater formalisation will enhance the productivity of individuals and businesses in the economy through improved access to credit and efficiency gains in their operations.

2.15 Gains from economic and structural reforms tend to be more significant when the binding constraints of governance have been addressed.[15] Unified digital interfaces that connect various initiatives/portals have simplified governance resulting in a more efficient resource allocation in the economy. The *National Single Window System* for business approvals, the *JanSamarth portal* for credit-linked Central Government scheme, and the *UMANG app* for access to Central and state government services are essential steps towards enhancing the ease of doing business through the integration of existing systems. *Eshram portal*, with more than 28.5 crore registered workers, has been integrated with various other digital portals for easy accessibility. *PM Gatishakti, the* GIS-based platform that brings together multiple ministries for integrated planning and coordinated implementation of multimodal infrastructure connectivity projects, aims to reduce logistics costs. Thus, digitaltechnologies being at the forefront of the reforms provide a unique opportunity to accelerate India's economic growth. More details on the strides in digital infrastructure may be seen in chapter 12.

II. Trust-based Governance

2.16 Building trust between the government and the citizens/businesses unleashes efficiency gains through improved investor sentiment, better ease of doing business, and more effective governance. Consistent reforms have been made in this direction during the last eight years. Simplification of regulatory frameworks through reforms such as the Insolvency and Bankruptcy Code (IBC) and the Real Estate(Regulation and Development) Act (RERA) have enhanced the ease of doing business. The IBC has imbibed some of the best international practices of an asset

12 'Imagine an India without hawkers', The Economist January 2023. (https://www.economist.com/finance-and-economics/2023/01/05/imagine-an-india-without-hawkers)
13 https://pqars.nic.in/annex/257/AU904.pdf
14 PMEAC Report- 'GST-Connecting the remaining dots', June 2022
15 IMF World Economic Outlook 2019

resolution mechanism. It provides an honourable exit mechanism for honest business failures and enables the release of credit locked into the stressed assets for better resource allocation. This market-driven, transparent resolution mechanism instils confidence in the financial system and attracts many new investors to invest in Indian businesses.[16] A significant achievement of the IBC has been the change brought in the debtor-creditor relationship. Debtors are resolving stress early to avoid being pushed into insolvency. Until 30 September 2022, 23,417 applications for initiating the corporate insolvency resolution process (CIRP) of corporate debtors having underlying defaults of ₹7.3 lakh crore were disposed of before their admission into CIRP. [17]

2.17 The other regulatory reform, Real Estate (Regulation and Development) Act (RERA), is creating a culture of transparent transactions in the real estate sector.[18] The Act has transformed the real estate sector by registering real estate brokers and agents with the regulator, establishing mechanisms for the speedy redressal of disputes and enabling a single window clearance for timely approvals to the developers. The Real Estate Regulatory Authorities across the country have disposed off more than 1.06 lakh complaints. With 99262 projects and 71514 agents already registered under RERA, the Act incentivises more investments into the sector.

2.18 Another significant reform to enhance doing business has been the decriminalisation of minor economic offences under the Companies Act of 2013 (Table II.2). By introducing civil liabilities for dealing with simple defaults that do not involve fraud or where the nature of the lapse is purely procedural, the government has demonstrated its intent to promote ease of doing business for domestic and global investors. Furthermore, a trust-based approach towards compliance builds entrepreneurs' faith in corporate institutions and motivates them to adopt fairer and more transparent business practices. After the reform, more than 1400 default cases have been decided without resorting to the court. Also, more than 4,00,000 companies have willingly rectified past defaults to avoid penalties under the Companies Act.[19]

Table II.2: Snapshot on decriminalisation of offences under the Companies Act, 2013

	Pre-decriminalisation	Post-decriminalisation [in two phases]
Total penal provisions	134	124
Compoundable offences [mostly fines are imposed]	81	31
Non-compoundable offences [serious offences where imprisonment is ordered upon conviction]	35	35
Defaults subject to civil liability (through In House Adjudication Mechanism)	18	58

2.19 The removal of policy uncertainties has favourable implications for strengthening the trust between the government and its citizens. Simplifying processes by doing away with 25000

16 Sahoo, M. S., & Guru, A. (2020). Indian Insolvency Law.Vikalpa,45(2), 69–78 (https://www.ies.gov.in/pdfs/Indian-Insolvency-Law-Dr-MS-Sahoo-and-Dr-Anuradha-Guru.pdf)

17 IBBI Quarterly newsletter (Jul-Sep 2022)

18 Speech by RBI Deputy Governor, R. Gandhi on 'Improving investor interest – Recent Legislative and Regulatory Measures' (2017) (https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/3IMITERST460080CE62954FB5960719A4B855C20C.PDF)

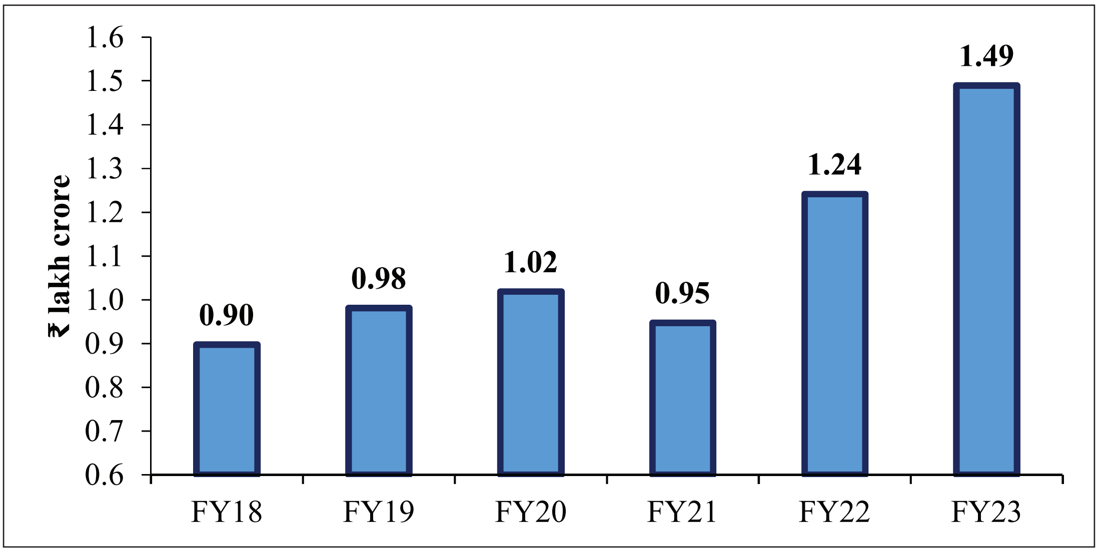
19 Using the Companies Fresh Start Scheme

unnecessary compliances, repealing more than 1400 archaic laws, abolishing the Angel tax and removing retrospective taxation on offshore indirect transfer of assets located in India, signal the government's resolve to ensure a non-adversarial policy environment. These efforts have improved investor sentiments and strengthened the growth potential.

2.20 In particular, the taxation ecosystem in the country has undergone substantial reforms in the post-2014 period. Tax policy reforms such as adopting a unified GST, reducing corporate tax rates, exemption of sovereign wealth funds and pension funds from taxes, and removing the Dividend Distribution tax have reduced the tax burden on individuals and businesses; and have removed the distortionary incentives from the economy. GST, for instance, has helped businesses by reducing compliances, ensuring a free flow of goods across states, doing away with the need for businesses to have a separate warehouse for every state, and hence improving the ease of doing business. The earlier indirect tax regime was origin based, and it distorted the location choices of the businesses.

2.21 Despite tax rationalisation, a positive trend of higher tax buoyancy is visible in the economy. The notable economist Indira Rajaraman termed GST 'a revenue success' in 2019[20]; thereafter, the positive GST revenue collection trends have strengthened further despite the pandemic. The average monthly gross GST collection has increased from ₹0.90 lakh crore in FY18 to ₹1.49 lakh crore in FY23 (Figure II.9). Evidence suggests that the buoyancy of the indirect tax system replaced by GST has improved in the post-GST regime (Box III.1, Chapter 3). Since other tax reforms, such as the corporate tax cut, were followed by the pandemic-led uncertainty and disruptions, their impact on collections is gradually becoming visible in higher tax collections. The Corporate tax collections for April to November 2022 have increased by 21.1 per cent on a YoY basis compared to a longer-term average YoY growth of 10.3 per cent during the corresponding period from FY13 to FY19.

Figure II.9: Rising average monthly gross GST collection



Source: Department of Revenue

20 Monograph titled 'The evolving GST' delivered by Indira Rajaraman as the Chelliah Memorial Lecture at the Madras School of Economics in 2019. (https://www.mse.ac.in/wp-content/uploads/2021/05/Monograph-43.pdf)

2.22 One prominent reason behind the higher revenue buoyancy is the introduction of technology-backed tax governance reforms for simplifying tax processes, enhancing compliance, and improving fraud detection systems. The faceless assessment and appeal systems no longer require a physical interface between taxpayers and the Income Tax department. Moreover, multiple consistency checks possible with integrated digital systems reduce tax evasion. As an illustration, the GST return filing mechanism results in better income reporting, leading to higher direct tax collections. In this regard, the decision to share data and information between CBDT and CBIC on an automatic and regular basis is a promising reform, and it would result in efficiency gains in the tax system. These reforms augur well for future economic growth and future resource mobilisation in the economy.

III. Promoting the private sector as a co-partner in the development

2.23 A fundamental principle behind the government's policy in the post- 2014 period has been the engagement with the private sector as a partner in the development process. The government's disinvestment policy has been revived in the last eight years with stake sales and the successful listing of PSEs on the stock market. During FY15 to FY23 (as of 18 January 2023), an amount of about ₹4.07 lakh crore has been realised as proceeds from disinvestment through 154 transactions using various modes/instruments. The privatisation of Air India was particularly significant for re-igniting the privatisation drive. Evidence shows that privatisation has improved labour productivity and the overall efficiency of the PSUs disinvested during 1990-2015.[21] The New Public Sector Enterprise Policy for Aatmanirbhar Bharat has thus been introduced to realise higher efficiency gains by minimising the presence of the government in the PSEs to only a few strategic sectors.

2.24 Significant initiatives have been introduced under Aatmanirbhar Bharat and Make in India programmes to enhance India's manufacturing capabilities and exports across the industries. Sector-specific Production Linked incentives (PLI) have been introduced in the aftermath of the pandemic to incentivise domestic and foreign investments and to develop global Champions in the manufacturing industry. The PLI scheme will significantly boost production, exports and employment in the medium term; however, its impact will be visible only with time. Early estimates of the impact of PLI show encouraging trends in some sectors. The PLI scheme for large-scale electronics manufacturing has attracted an investment of ₹4,784 crore and contributed to a total production of ₹2.04 lakh crore, including exports of ₹80,769 crore (as of September 2022)[22]. The need for a dedicated government policy to support domestic industrialisation amidst foreign competition can be better appreciated from the industrialisation experiences of East Asian countries such as South Korea and Taiwan in 1960-1990. These countries supported their domestic industries during their high growth phase, while also ensuring healthy competition required for the industries to grow.[23]

2.25 Production incentives under Aatmanirbhar Bharat also incentivise foreign investments for domestic production. The last eight years have seen further liberalisation of the policy towards foreign investors, with most sectors now open for 100% Foreign Direct Investment (FDI) under the automatic route. This has resulted in a visible structural shift in the gross FDI flows to India

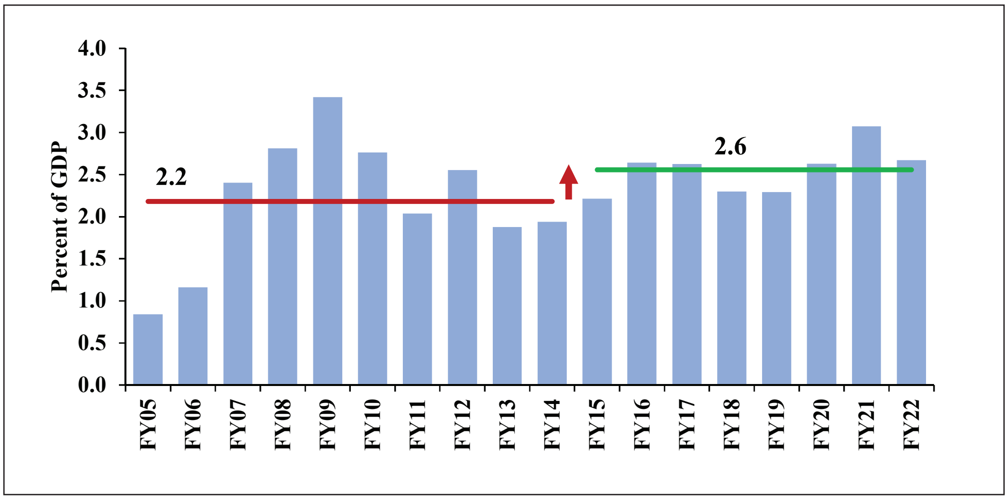
21 Chhibber, Ajay & Gupta, Swati, 2017. "Bolder Disinvestment or Better Performance Contracts? Which Way Forward for India's State-Owned Enterprises,"Working Papers17/205, National Institute of Public Finance and Policy.

22 https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1885189

23 Jostein Hauge, 2020. "Industrial policy in the era of global value chains: Towards a developmentalist framework drawing on the industrialisation experiences of South Korea and Taiwan," The World Economy, Wiley Blackwell, vol. 43(8), pages 2070-2092, August.

during the last decade. India's gross FDI has increased from an average of 2.2 per cent of GDP during FY05-FY14 to 2.6 per cent in FY15-FY22 (Figure II.10). The highest-ever annual gross FDI inflow of USD 84.8 billion was recorded in FY22. These trends are an endorsement of India's status as a preferred investment destination amongst global investors.

Figure II.10: Structural shift in the Gross FDI/GDP during 2014-15



Source: RBI Handbook of Statistics on the Indian Economy (FDI data); International Monetary Fund World Economic Outlook database (Oct.2020) for US dollar GDP at current prices

2.26 The government is developing enabling infrastructure for making India a cost-effective production hub. The National Logistics Policy (2022)[24] has been launched to create an overarching logistics ecosystem for lowering the cost of logistics and bringing it to par with other developed countries. This would boost economic growth, provide employment opportunities, and make Indian products more competitive in the global market. Moreover, opening the strategic sectors, such as defence, mining and space, for the private sector has enhanced the business opportunities in the economy. Investment incentives and easing business compliances have created an ecosystem for the start-ups to nurture. The number of recognised Start-ups has increased from 452 in 2016 to 84,012 in 2022. More details on reforms for industries may be seen in Chapter 9.

2.27 Reforms to address the structural challenges faced by MSMEs have been a vital part of the industrial policy in recent years. Support measures for MSMEs during the pandemic in the form of the Emergency Credit Line Guarantee Scheme (ECLGS) and revision in the definition of MSMEs under the ambit of Aatmanirbhar Bharat helped them face the crisis shock. The ECLGS, in particular, has in the last two years benefited 1.14 crore MSMEs, which have availed collateral-free loans amounting to ₹2.38 lakh crore. Further measures, such as the introduction of TReDS to address the delayed payments for MSMEs, the inclusion of Retail and Wholesale trades as MSMEs, and the extension of non-tax benefits for three years in case of an upward change in the status of MSMEs, have created a resilient support system for the MSME sector to grow. The MSMEs have also benefitted from access to digital platforms for their marketing needs and easy payments. With the Open Network for Digital Commerce creating opportunities for MSMEs to access e-commerce technology and diversify their target markets, this trend will likely strengthen further. Moreover, onboarding GSTN as a Financial information provider

24 Details in Chapter 12

on the Account aggregator platform will open up avenues for access to credit for MSMEs. Enhancing opportunities and productivity of the MSME sector have large-scale implications for a resilient production ecosystem, thus strengthening the growth prospects of the industry and the economy as a whole. These reforms, therefore, must continue.

IV. Enhancing productivity in agriculture

2.28 The agriculture sector in India has grown at an average annual growth rate of 4.6 per cent during the last six years. This growth is partly attributable to good monsoon years and partly to the various reforms undertaken by the government to enhance agricultural productivity. Policies such as Soil Health Cards, the Micro irrigation Fund, and organic and natural farming have helped the farmers optimise resource use and reduce the cultivation cost. The promotion of Farmer Producer Organisations (FPOs) and the National Agriculture Market (e-NAM) extension Platform have empowered farmers, enhanced their resources, and enabled them to get good returns. Agri Infrastructure Fund (AIF) has supported the creation of various agriculture infrastructures. Kisan Rail exclusively caters to the movement of perishable Agri Horti commodities. Cluster Development Programme (CDP) has promoted integrated and market-led development for horticulture clusters. Support for creating a Start-up ecosystem in agriculture and allied sectors is also being provided to the farmers. All these measures are directed towards supporting the growth in agricultural productivity and sustaining its contribution to overall economic growth in the medium term.

Returns to the Economic and Structural Reforms after 2014

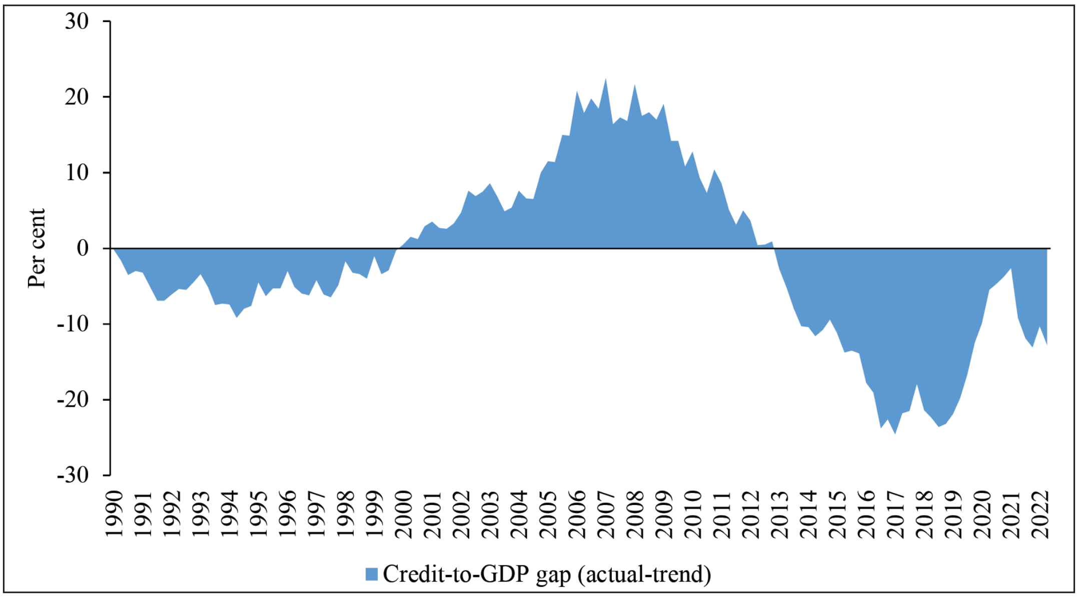
Shocks that the economy faced during 2014-22

2.29 Under normal circumstances, comprehensive and wide-ranging reforms undertaken in the economy during the last eight years (as covered in the previous section) would have accelerated India's growth. But that was not to be. The 'culprit' is India's balance sheet stress caused by the credit boom in previous years. As per data from the Bank for International Settlements, India's non-financial private sector debt to GDP ratio went up from 72.9 per cent in March 2004 to 113.6 per cent by December 2010. That is an increase of 40.7 percentage points in just over six years. In rupee terms, the amount of debt accumulated by the non-financial sector went up from nearly 44 lakh crore to almost 133 lakh crore. It trebled in six years. Despite limited economic reforms, global capital flows and optimism about BRICS (Brazil, Russia, India, China and South Africa) triggered a domestic credit and investment boom that eventually proved unsustainable, as the twin deficit – fiscal and external - crisis of 2013 revealed. Thereafter the non-financial private sector debt to GDP ratio began to come down meaningfully only from 2015 onwards, dropping to a low of 83.8 per cent by December 2018. That is nearly a 30 percentage point reduction from 113.6 per cent in December 2010 over eight years.

2.30 Unsurprisingly, the credit to the private non-financial sector as a per cent of GDP was consistently below its trend value for most of the second decade of the millennium, implying a negative credit gap to GDP ratio (Figure II.11). The gap worsened to an unprecedented level of 25 per cent in 2017. A statistically significant negative correlation (-0.5) between the Gross NPAs and credit growth shows that the banks' credit supply was severely constrained due to stress in their balance sheet during the second decade.[25] That explains the large negative deviation of the credit-to-GDP ratio from its trend.

25 Muduli, S. and Behera, H., 2021. Bank capital and monetary policy transmission in India. Macroeconomics and Finance in Emerging Market Economies, pp.1-25. (https://bit.ly/3J9xvNG)

Figure II.11: Quarterly Credit to GDP Gap remained negative for most of the 2010s



Source: BIS

2.31 As investments made by companies went sour, it impaired their ability to repay bank loans. Hence, banks' non-performing assets began to rise. That set in motion a long period of repair of the financial and non-financial sector balance sheets in the second half of the last decade. The government and the RBI took several policy initiatives to help the financial sector recoup the balance sheet stress during the 2010s. Some of these such as the amendment to the SARFAESI Act 2002, implementation of the Insolvency and Bankruptcy Code (IBC), launch of 'Asset Quality Review' (AQR), introduction of prompt corrective action (PCA) framework, recapitalisation of Public Sector Banks (PSB), and merger of PSBs among others, helped in cleaning up the balance sheets of banks/corporates.

2.32 Even as the balance sheets of banks and companies began to mend and improve, came the collapse of the Infrastructure Finance and Leasing Services (IL&FS) in September 2018. It was a big non-banking financial company (NBFC) with a huge asset base. Its collapse also had a huge ripple effect on other non-banking financial entities. Few housing finance companies went under as well. Hence, housing loan disbursements were disrupted. Usually, non-banking finance companies lend to more borrowers and riskier borrowers than banks. They are refinanced by banks. Their re-financings came down in the wake of the collapse of IL&FS, a big NBFC, followed by the collapse of some housing finance companies. Therefore, bank credit growth came down to single digits towards the end of 2019, continuing into 2020. Low credit growth and hence weaker capital formation impacted economic growth.

2.33 The government responded with several measures to stem the fallout of the collapse of IL&FS and housing finance companies, including a corporate tax cut in September 2019. Soon thereafter, the pandemic struck, and the government had to address the emerging health, social and economic consequences of unprecedented nature. These have been discussed in detail in the previous two economic surveys of 2020-21 and 2021-22. These back-to-back shocks have delayed the impact of such momentous reforms on the economic growth.

The Period 2014-2022 is Analogous to the Period 1998-2002

2.34 India's recent economic history provides a similar parallel to this situation. During 1998-2002, transformative reforms were launched but yielded lagged growth dividends (Table II.3). This phenomenon was attributed to a series of one-off shocks resulting from external factors and the domestic financial sector clean-up, which overshadowed the growth returns from 1998 to 2002[26]. By 2003, when the shocks dissipated, India participated in the global boom and grew at a higher rate. Similarly, in the present context, as the global shocks of the pandemic and the spike in commodity prices in 2022 fade away, the Indian economy is well placed to grow at its potential in the coming decade.

Table II.3: A parallel between the periods: 1998-2002 and 2014-2022

1998-2002	2014-2022
Shocks to the economy	
◆ Nuclear device testing 1998; sanctions followed	◆ Period of Banking, Non-Banking and Non-Financial Corporate Sector Balance-sheet stress
◆ Banking and Corporate Sector deleveraging and repairing balance-sheets ◆ Two successive droughts ◆ Technology bust; US recession and 09/11	◆ Unprecedented pandemic shock followed by inflation global commodity price shock followed by tightening of financial conditions
Structural reforms in the economy	
◆ Interest rate deregulation ◆ Privatisation ◆ Asset Recovery for banks ◆ Infrastructure (Golden quadrilateral) ◆ FRBM Act	◆ Unique Identity ◆ Financial Inclusion ◆ GST leading to formalisation ◆ Insolvency & Bankruptcy Code ◆ Privatisation ◆ Tax rates rationalisation and tax administration reforms ◆ Decriminalisation of offences ◆ Vaccines roll-out ◆ Expenditure Management Reforms ◆ AatmaNirbhar Bharat ◆ Public Digital Infrastructure
Growth returns	
◆ One-off shocks delayed the growth returns	◆ Balance sheets strengthened in the financial sector; the corporate sector deleveraged by about 30 percentage points (Non-financial private sector debt to GDP ratio)
◆ Once shocks faded away, structural reforms paid growth dividends from 2003 onwards	• Emphasis on macro-economic stability while dealing with global shocks

26 Refer Paragraph 6 of this chapter for details

Growth Magnets in this Decade (2023-2030)

India is prepared to grow at its potential once the one-off shocks recede

2.35 After a long period of balance sheet repair in the financial and corporate sector, the financial cycle is poised to turn upward. As the health and economic shocks of the pandemic and the spike in commodity prices in 2022 wear off, the Indian economy is thus well placed to grow at its potential in the coming decade, similar to the growth experience of the economy after 2003. **This is the primary reason for expecting India's growth outlook to be better than it was in the pre-pandemic years**. The sound and healthy financial system developed over the last few years will ensure efficient credit provisioning, contributing to higher growth in the coming years through higher investments and consumption. Thanks to India's digital revolution and formalisation, banks have far more information about their customer's credit risks than before, thus being able to make credit and pricing decisions better than before. That should make for a healthier and longer credit cycle than before. Bank credit growth has been well into double-digits for quite some time now. A recent IMF Working paper[27] analyses the trends in the Credit-to-GDP ratio gap[28], bank balance sheets and the GDP growth in India since 2012; and shows that better-capitalised banks result in higher credit growth, which further translates into higher GDP growth.

2.36 The digitalisation reforms and the resulting efficiency gains in terms of greater formalisation, higher financial inclusion, and more economic opportunities will be the second most important driver of India's economic growth in the medium term. In its recent Article IV report for India, IMF highlighted that India's successful implementation of the wide-ranging reforms and more than expected dividends from digitalisation could increase India's medium-term growth potential. [29] These productivity-enhancing reforms along with the Government's Skilling initiatives, will also help unleash the benefits of the demographic dividend in the coming years. In sum, various initiatives undertaken in the last eight years have bolstered India's growth potential, and it will be reflected in actual GDP growth as the effects of one-off the shocks recede.

2.37 The evolving geo-political situation also presents an opportunity for India to benefit from the diversification of global supply chains. The last few years have exposed multinational firms to unprecedented risks due to global trade tensions, pandemic-induced supply chain disruptions, and the conflict in Europe. Firms were exposed to the risk of concentrating their production in a single country. Therefore, given the global policy uncertainty, multinational firms are gradually exploring strategies to diversify their production bases and supply chains. UNCTAD, in one of its reports, shows that 'reshoring, diversification, and regionalisation will drive the restructuring of global value chains in the coming years'.[30] With enabling policy frameworks, India presents itself as a credible destination for capital diversifying out of other countries.[31] [32]

27 IMF Working paper (WP/22/137)- Financial Sector and Economic Growth in India by Margaux MacDonald;TengTeng Xu (July 2022) – (https://www.imf.org/en/Publications/WP/Issues/2022/07/08/Financial-Sector-and-Economic-Growth-in-India-520580)

28 Difference between actual ratio and its trend value

29 https://www.imf.org/en/Publications/CR/Issues/2022/12/21/India-2022-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-527283

30 UNCTAD World Investment report 2020 (https://unctad.org/news/covid-19-will-likely-transform-global-production-says-un-report; https://unctad.org/system/files/official-document/wir2020_en.pdf)

31 'Helped by PLI scheme, Apple's India exports set to hit Rs 20,000 crore', Business Standard, December 2022 (https://www.business-standard.com/article/companies/helped-by-pli-scheme-apple-s-iphone-exports-from-india-hit-record-122121200940_1.html)

32 'India to get more Apple suppliers as iPhone production picks up: Experts', Business Standard, December 2022 (https://www.business-standard.com/article/technology/india-to-get-more-apple-suppliers-as-iphone-production-picks-up-experts-122121900505_1.html)

The recently published Chief Economists Outlook 2023 (World Economic Forum) highlights India's opportunity to gain from these global trends of supply chain diversification.[33]

2.38 While the new age reforms undertaken over the last eight years form the foundation of a resilient, partnership-based governance ecosystem and restore the ability of the economy to grow healthily, further reforms are needed to ensure that economic growth can both accelerate and be sustained at higher levels, to deliver a better quality of life. The deregulation and simplification of compliances should continue to dismantle the licensing, inspection and compliance regime entirely. State governments have to address power sector issues, and the financial viability concerns of the Discoms have to be addressed. Impetus must be given to education and skilling to match the requirements of modern industry and technologies, deal with twenty-first-century challenges such as climate change and energy transition, and make the most of India's demographic dividend. Initiatives to sensitise the population towards a healthy lifestyle should be continued. Strategies to arrest and reverse the rising obesity levels should be adopted.[34] Long-range plans need to be formulated to secure the necessary metals and minerals required for energy transition and diversification. Determined efforts should be taken to make the public sector asset monetisation scheme successful in realising wide-ranging efficiency gains from the programme. If asset monetisation revenues are used to reduce public sector debt, the sovereign credit rating will improve, leading to a lower cost of capital. That will be the biggest fiscal stimulus to the economy. Reforms to reduce the compliance burden on MSMEs, enhance their access to finance and working capital and equip them with skills, knowledge and attitude to grow their businesses responsibly must continue. State governments should make conclusive progress on the various factor market reforms in different stages of completion.

2.39 In this chapter, we have shown that the Indian economy had not lost its vigour, nor have government reform measures their effectiveness. The Indian economy could have grown faster in the absence of the financial and corporate sector balance sheet stress. Even as we were looking forward to the economy being able to reap the benefits of improved and healthier balance sheets in the new decade, it was buffeted by the global pandemic followed by a sharp rise in the prices of food, fuel and fertiliser. Negative shocks will and do fade, as they did in the early years of the new millennium. Now, financial and corporate sector balance sheets are in good shape, and there is a willingness to borrow and lend. Hence, it is inevitable that the effects of these reforms will now shine through. A restored credit cycle will rejuvenate the Indian private sector capex cycle. That alone is adequate to enable India to grow at least 6 per cent per annum in real terms. On top of that, the higher economic efficiency resulting from the public digital infrastructure created over the last 6-7 years will also add 30- 50 basis points to the potential GDP growth. The growth effects of the maturation of India's public digital infrastructure are insufficiently understood. Formalisation and financial inclusion that it has enabled are too evident to be ignored. It is a matter of time before its growth effects become persistent in the data. That is why we are optimistic that India will achieve an average of 6.5 per cent real GDP growth in the medium term. In addition, if the other reforms explained in the previous paragraph are pursued in the coming years, India's potential GDP growth can rise to 7-8 per cent per annum in the medium term.

33 Chief Economists Outlook 2023 (World economic Forum)- https://www.weforum.org/reports/chief-economists-outlook-jan-2023

34 As per National Family Health Survey 5, Obesity is rising for both men and women across all states .

03 CHAPTER

FISCAL DEVELOPMENTS: REVENUE RELISH

The Union Budget for FY23 was presented in an uncertain macroeconomic environment. Soon after its presentation, the geopolitical conflict aggravated global supply disruptions and adversely impacted the prices of fuel, food, and other essential commodities. The Government of India's fiscal policy response to the crisis comprised of a judicious mix of increasing food and fertiliser subsidies on the one hand and a reduction in taxes on fuel and certain imported products on the other. Despite these additional fiscal pressures during the year, the Union Government is on track to achieve the budget estimate for the fiscal deficit in FY23. The resilience in the fiscal performance of the Union Government has been facilitated by the recovery in economic activity, buoyancy in revenues from direct taxes and GST, and realistic assumptions in the Budget. The Gross Tax Revenue registered a YoY growth of 15.5 per cent from April to November 2022, driven by robust growth in the direct taxes and Goods and Services Tax (GST). The growth in direct taxes during the first eight months of the year was much higher than their corresponding longer-term averages. The GST has stabilised as a vital revenue source for central and state governments, with the gross GST collections increasing at 24.8 per cent on YoY basis during April - December 2022.

On the expenditure side, the Union Government's emphasis on capital expenditure (Capex) has continued despite higher revenue expenditure requirements during the year. The Centre's Capex has steadily increased from a long-term average of 1.7 per cent of GDP (FY09 to FY20) to 2.5 per cent of GDP in FY22 PA. The Centre has also incentivised the State Governments through interest-free loans and enhanced borrowing ceilings to prioritise their spending on Capex. With an emphasis on infrastructure-intensive sectors like roads and highways, railways, and housing and urban affairs, the increase in Capex has large-scale positive implications for medium-term growth. This Capex-led growth strategy will enable India to keep the growth-interest rate differential positive, leading to a sustainable government debt to GDP in the medium run.

Introduction

3.1 With the continuing global risks and uncertainties, the availability of fiscal space with governments has become paramount. It is especially true following the recent incidence of the pandemic when the fiscal policy became an effective macroeconomic stabilisation tool globally. In India, particularly when all economic activities had reached a standstill, fiscal policy was instrumental in providing a safety net to the vulnerable, reviving the economy by boosting demand, and addressing certain domestic supply-side constraints through public investments and sustained structural reforms.

3.2 The large, frontloaded packages across the countries led to over-stimulation of demand, leading to its much faster recovery. In combination with the still-existing supply disruptions and constraints, the overheating of the economy led to inflationary pressures. The conflict in Europe and the related geopolitical developments aggravated the crisis. The slowing global growth, rising interest rates, persistently high inflation rates and uncertain global environment have thus posed certain pertinent questions for fiscal-policy experts to motivate the overarching fiscal policy strategy. How to evaluate the trade-off between maintaining fiscal support to manage the continuing crisis versus withdrawing fiscal stimulus from the economy to control inflation and regain the lost fiscal space? When to do so and at what pace? While a sudden withdrawal may have costs for medium-term growth, a slow withdrawal may be inflationary and hence put upward pressure on yields, making the debt costly. Moreover, the financial markets may have less tolerance for fiscal unorthodoxy in an era of rising interest rates[1].

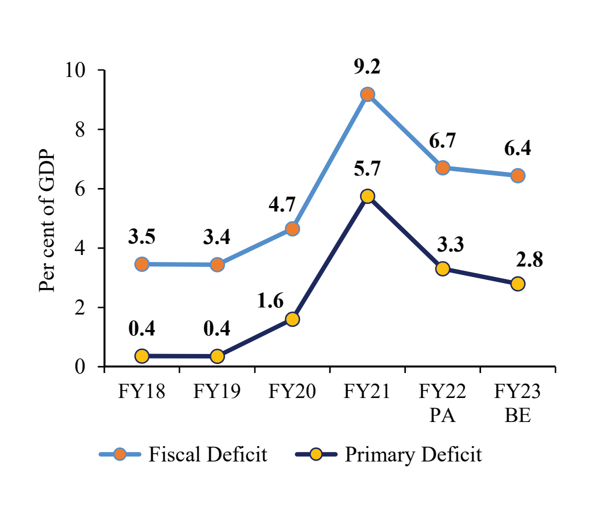
3.3 Against this backdrop, the Government of India adopted a calibrated fiscal response to the pandemic and planned to withdraw the fiscal stimulus gradually as it moves along the glide path outlined in the Budget FY22. This chapter discusses the government's fiscal strategy amidst uncertain geopolitical developments. The chapter starts with a discussion of the performance of the Union Government's finances, followed by an overview of the State finances. It concludes with a commentary on India's debt profile.

Developments in Union Government finances

3.4 While India entered the pandemic with a stretched fiscal position, the government's prudent and calibrated fiscal response enabled stable public finances even amidst the present uncertainties. The fiscal deficit of the Union Government, which reached 9.2 per cent of GDP during the pandemic year FY21, has moderated to 6.7 per cent of GDP in FY22 PA and is further budgeted to reach 6.4 per cent of GDP in FY23 (Figure III.1). This gradual decline in the Union government's fiscal deficit as a per cent of GDP, in line with the fiscal glide path envisioned by the government, is a result of careful fiscal management supported by buoyant revenue collection over the last two years.

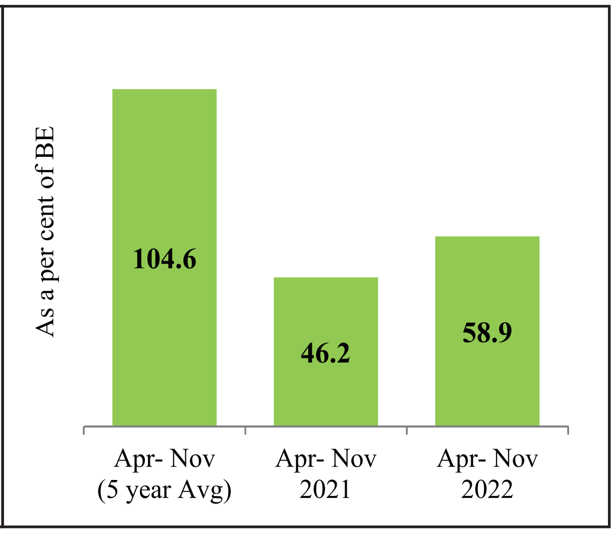
[1]'Ruchir Sharma's investor guide to 2023: from peak dollar to better TV', Financial Times, 6th January 2023 (https://www.ft.com/content/3e040c2c-f7e4-4121-9dfe-7ba5732707f7)

Figure III.1: Trends in Union government deficits over the years- On the way to fiscal consolidation



Source: Union Budget documents, O/o CGA

Figure III.2: Government on track to achieve the Fiscal deficit target for FY23



Source: O/o CGA

Union Government on track to achieve the Fiscal deficit target for FY23

3.5 The Union Budget for FY23 was presented in a recovering yet uncertain macroeconomic environment, not anticipating the geopolitical developments that unfolded during the year. As the conflict in Europe broke out early in the year, it aggravated supply disruptions and had an adverse impact on the prices of fuel, food, and other essential commodities. The government's fiscal policy response necessitated additional spending on food and fertiliser subsidies, accompanied by specific duty cuts to control the pass-through of the high imported prices to the consumers/ users. Despite additional fiscal resource pressures during the year, the Union Government is well on track to achieve the budget estimate for the fiscal deficit in FY23. The fiscal deficit of the Union Government at the end of November 2022 stood at 58.9 per cent of the BE, lower than the five-year moving average of 104.6 per cent of BE during the same period (Figure III.2).

Conservative budget assumptions provide a buffer during global uncertainties.

3.6 This resilience in the fiscal performance of the Centre has resulted due to a recovery in economic activity, buoyancy in revenues observed during the year, and conservative assumptions of macroeconomic variables in the Budget. The prudent assumptions in Budget FY23 provided a buffer to the government during global uncertainties. As an illustration, the Gross Tax Revenue (GTR) to the Centre was envisaged to grow at 9.6 per cent in FY23 BE relative to FY22 RE. However, given the higher 'Provisional Actual' figures recorded for the GTR relative to the Revised estimates in FY22, the growth in GTR of FY23 BE turns out to be a mere 1.8 per cent over FY22 PA. Against this implicit (budgeted) growth, the data of the first eight months of the year show that GTR has grown at a much higher rate (Table III.1). The annual estimate of GTR for FY23 is thus expected to overshoot the budget estimates.

Table: III.1: Stable performance of the Union Government fiscal indicators from April to November 2022

	₹ lakh crore			As a per cent of BE		YoY growth (per cent)		
	BE FY23	Apr-Nov 2021	Apr-Nov 2022	Apr-Nov 2021	Apr-Nov 2022	5 yr Avg Apr-Nov	Apr-Nov 2021	Apr-Nov 2022
Revenue Receipts	22.04	13.58	14.23	75.9	64.6	12.3	67.1	4.8
Gross tax revenue	27.58	15.42	17.81	69.5	64.6	13.9	50.3	15.5
Assignment to States	8.17	4.03	5.51	60.5	67.5	16.6	20.4	36.8
Tax Revenue (net to Centre)	19.35	11.35	12.25	73.5	63.3	12.9	64.9	7.9
Non-Tax Revenue	2.70	2.23	1.98	91.8	73.5	13.3	79.5	-11.1
Non-Debt Capital Receipts	0.79	0.21	0.41	11.0	52.3	30.6	14.1	100.4
Non-Debt receipts	22.84	13.79	14.65	69.8	64.1	12.2	66.0	6.2
Total Expenditure	39.45	20.75	24.43	59.6	61.9	11.4	8.8	17.7
Revenue Expenditure	31.95	18.01	19.96	61.5	62.5	11.4	8.2	10.8
Capital Expenditure	7.50	2.74	4.47	49.4	59.6	12.9	13.5	63.4
Revenue Deficit	9.90	4.43	5.73	38.8	57.8	11.4	-48.1	29.3
Fiscal Deficit	16.61	6.96	9.78	46.2	58.9	11.5	-35.3	40.6
Primary Deficit	7.21	2.34	4.33	33.5	60.1	13.1	-66.2	85.1

Source: Union Budget documents, O/o CGA

Performance of Union Government Non-debt Receipts

3.7 The Union government's non-debt receipts comprise revenue receipts (tax and non-tax) and non-debt capital receipts. The shortfall in the non-debt receipts to meet the expenditure requirement is met by borrowings of the government (called fiscal deficit). This section evaluates the performance of the Receipts side of the Union Government's finances.

Sustained revenue buoyancy over the last two years

3.8 After plummeting during the pandemic-affected year FY21, revenue receipts registered robust growth in FY22 PA, both on a YoY basis and to the pre-pandemic year FY20 (Annexe 1: Table 3). This revenue revival was attributed to a rebound in the collection of all major direct and indirect taxes (except excise duties) in FY22. Last year's revenue buoyancy momentum is continuing into the current year. The Gross Tax Revenue registered a YoY growth of 15.5 per cent from April to November 2022, and the Net Tax Revenue to the Centre after the assignment to states grew by 7.9 per cent on a YoY basis (Table III.1, III.2).

Table: III.2: Buoyant Union Government taxes from April to November 2022

	In ₹ lakh crore			As a per cent of BE		YoY growth (per cent)	
	BE FY23	Apr-Nov 2021	Apr-Nov 2022	Apr-Nov 2021	Apr-Nov 2022	Apr-Nov 2021	Apr-Nov 2022
Gross Tax Revenue, of which	27.58	15.42	17.81	69.5	64.6	50.3	15.5
Direct taxes	14.20	7.00	8.67	63.1	61.0	66.3	23.9
a. Corporation Tax	7.20	3.54	4.28	64.6	59.5	90.4	21.1
b. Taxes on income other than Corporation tax	7.00	3.46	4.39	61.7	62.7	47.2	26.7
Indirect taxes	13.30	8.21	8.91	74.5	67.0	38.6	8.5
c. Custom	2.13	1.26	1.41	92.5	66.4	99.5	12.4
d. Union Excise Duties	3.35	2.42	1.91	72.2	57.1	23.2	-20.9
e. Service Tax	0.02	0.01	0.00	50.2	20.4	-52.6	-18.7
f. GST	7.80	4.53	5.57	71.9	71.5	36.5	23.1

Source: Union Budget documents, O/o CGA

3.9 The resilience exhibited by economic growth underpins the sustained revenue buoyancy observed over the years. However, that revenues have grown at a pace much higher than the growth in GDP is a testimony to the effectiveness of efforts taken by the government to expand the tax base and enhance tax compliance. Structural reforms like the introduction of GST and the digitalisation of economic transactions have led to the greater formalisation of the economy and hence expanded the tax net. Other tax administration/policy measures, such as the Faceless Assessment and Appeal, simplification of return filing, assistance to taxpayers in getting familiar with the systems, generation of e-way bills under the GST system, and information sharing between government departments among others, have nudged higher tax compliance through technology and artificial intelligence. Details may be seen in Annexe 2 and 3.

Direct taxes propelling the growth in Gross tax revenue

3.10 Direct taxes, which broadly constitute half of the Gross Tax Revenue (Figure III.3), have registered a YoY growth of 26 per cent from April to November 2022, enabled by corporate and personal income tax growth. The growth rates observed in the major direct taxes during the first eight months of FY23 were much higher than their corresponding longer-term averages (Figure III.4).

Figure III.3: Composition of tax profile of Union Government (FY23 BE)

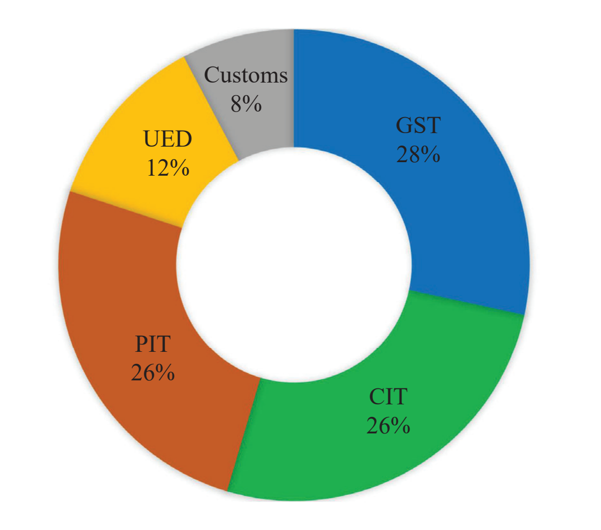
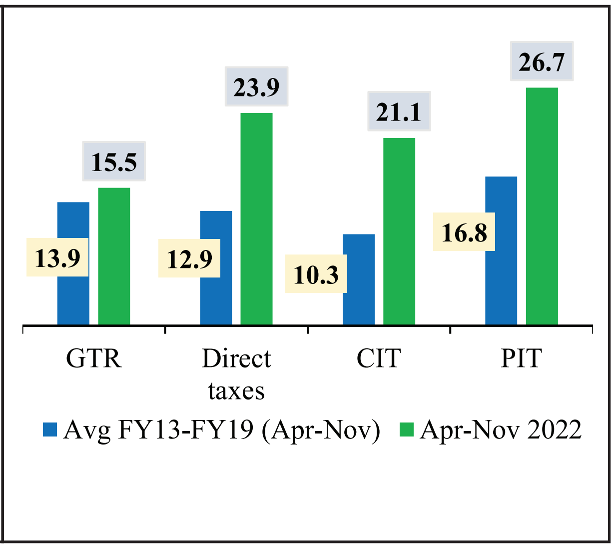


Figure III.4: Growth in Centre's direct taxes are higher than their corresponding longer-term averages during the period April to November



Source: Union Budget FY23, O/o CGA
Note: GTR - Gross Tax Revenue, GST - Goods and Services Tax, CIT - Corporation Income Tax, PIT - Taxes on Income other than Corporation Income Tax.m UED - Union Excise Duties

Customs and Excise duties act as Flexi-fiscal policy tools

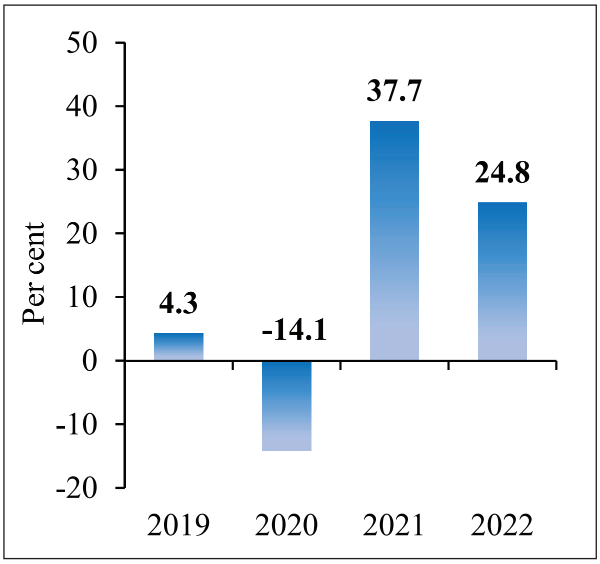
3.11 While direct taxes have safeguarded the revenue buoyancy, indirect taxes such as customs and excise duties have acted as flexible policy tools during the fiscal response to the pandemic. When the collection of direct and indirect taxes was adversely impacted during the pandemic year FY21, and low global oil prices created some elbow room for raising taxes on petroleum, the government raised the excise duty on petrol and diesel to augment the revenue pool. Subsequently, when other taxes recovered and inflationary pressures built up in the economy, the government reduced the excise duty in November 2021 and May 2022 to control the pass-through of the rising global oil prices on the consumers. The budget estimate had factored in negative growth of 15 per cent on excise collections for FY23. In line with the expectation, the excise duty collection has declined by 20.9 per cent from April to November 2022 on a YoY basis.

3.12 Given the rise in prices of essential imported products during FY23, customs duties were brought down on several items to control the inflation impact on edible oils, pulses, cotton, steel, etc. However, high imports during the current year have led to a 12.4 per cent YoY growth in the customs collection from April to November 2022 (Table III.2), which is higher than the average growth during the corresponding period from FY13 to FY19.

Stabilising Goods and Services Tax yielding returns

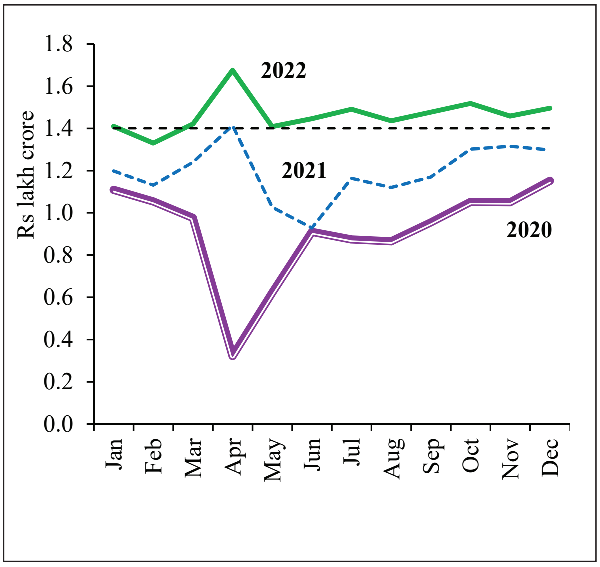
3.13 The Goods and Services Tax (GST) has evolved and stabilised as a vital revenue source for central and state governments (may refer Box III.1). Their gross GST collections, taken together, were ₹13.40 lakh crore from April to December 2022. Thus, implying a YoY growth of 24.8 per cent (Figure III.5). The pick-up in GST collections was consistently spread across all the months during the current fiscal year, with an average monthly collection of ₹1.5 lakh crore (Figure III.6). The improvement in GST collections has been due to the combined effect of the rapid economic recovery post-pandemic, the nationwide drive against GST evaders and fake bills along with many systemic changes introduced recently, and various rate rationalisation measures undertaken by the GST Council to correct inverted duty structure. Consistent efforts have resulted in a doubling of the GST net, with the number of GST taxpayers increasing from nearly 70 lakh in 2017[2] to more than 1.4 crore in 2022. Apart from directly supporting government revenues, GST has led to better reporting of income, which in turn has positive externalities for income tax collection and economic activity.

Figure III.5: High YoY growth in cumulative Gross GST collections from April to December



Source: Department of Revenue

Figure III.6: Continued momentum in monthly Gross GST collections over the years



Source: Department of Revenue

Box III.1: Maturing system of indirect tax collections

Has the shift to GST improved or worsened the buoyancy of India's indirect tax system? This box attempts an analysis to shed light on this question.

The aggregate State and Central taxes subsumed in the GST exhibited a CAGR of 11.53 per cent in the pre-GST period (FY13 to FY17). The nominal GDP grew at a CAGR of 11.54 per cent during this period (see items 1 to 7 of Table 1A). Since the growth of the subsumed taxes was marginally less than the growth of GDP, the buoyancy was just below one and could be taken as one for practical purposes.

The post-GST period experienced many headwinds, most notably the exogenous shock of the Covid pandemic. The nominal GDP grew at a slower CAGR of 9.6 per cent in the post-GST years (FY19 to FY23). However, GST collections have grown at a CAGR of 10.9 per cent (see items 8 to 10 of Table 1B), implying aggregate GST collections buoyancy of around 1.1. This has occurred even though the effective GST rate has fallen from inception (from 14.4 per cent in 2017 to 11.6 per cent in 2019, according to RBI).

[2]PMEAC Report- 'GST-Connecting the remaining dots', June 2022

Improved tax collection efficiency was one of the main arguments in favour of GST. The evidence so far suggests that GST is indeed showing a higher buoyancy than the pre-GST system. This augurs well for future resource mobilisation in the economy.

Comparing the performance of All taxes subsumed in GST (Pre vs post-GST period)

Table 1A: Pre GST period

	FY13	FY14	FY15	FY16	FY17	CAGR (FY17 over FY13)
				₹ lakh crore		
State taxes subsumed in GST						
1. Subsumed total state tax collection on GST portal	2.86	3.09	3.32	3.97	3.92	
2. Augmented total states taxes subsumed in GST[(a)]	3.22	3.48	3.73	4.41	4.41	
Central taxes subsumed in GST						
3. Union Excise duties from non-petroleum products	0.33	0.35	0.34	0.37	0.60	
4. Service tax	1.33	1.55	1.68	2.11	2.54	
5. Total of Central taxes subsumed in GST ((3)+(4))	1.66	1.90	2.02	2.48	3.14	
6. Total taxes subsumed in GST (Centre + States) ((2)+(5))	4.88	5.37	5.75	6.90	7.55	11.53%
7. Nominal GDP	99.44	112.34	124.68	137.72	153.92	11.54%
Buoyancy of total subsumed taxes in GST						**0.9988**

Table 1B: Post GST period

	FY19	FY20	FY21	FY22	FY23*	CAGR (FY23 over FY19)
				₹ lakh crore		
8. Total GST collections (domestic supplies)	8.77	9.44	8.66	10.98	12.94	10.2%
9. Total GST collections (including GST on imports)	11.77	12.22	11.37	14.90	17.80	10.9%
10. India Nominal GDP	189.00	200.75	198.01	236.65	273.09	9.6%
Buoyancy of GST collections (domestic supplies)						**1.0603**
Buoyancy of GST collections (including GST on imports)						**1.1299**

Note: (a) State taxes subsumed in the GST are taken from the GST portal. Since the data presented in the portal does not include the subsumed state taxes for Gujarat, Haryana, and Arunachal Pradesh, the data is augmented to arrive at an all-inclusive collections figure (Row B).
*(b) * The collection for FY23 have been extrapolated based on the average collections from May to Dec 2022.*
Sources: Department of Revenue, Union budgets, MoSPI, PIB releases.

Centre on track to meet Non-Tax Revenue targets

3.14 The non-tax revenue to the Centre mainly includes interest receipts on loans to States and Union Territories, dividends and profits from Public Sector Enterprises and the Reserve Bank of India, and external grants and receipts for services the Union Government provides. Budget FY23 envisaged a lower collection of non-tax revenue receipts during the current year relative to FY22 (around 22.5 per cent lower than FY22 PA) (Table III.3). Of the budgeted amount, 73.5 per cent has been collected up to November 2022.

Table III.3: Trends in Non-tax Revenue of Union Government

	FY18	FY19	FY20	FY21	FY22 PA	FY23 BE	Apr-Nov 2022
							₹ lakh crore
Interest receipts	0.14	0.12	0.12	0.17	0.22	0.18	0.17
Dividends & Profits	0.91	1.13	1.86	0.97	1.61	1.14	0.68
External Grants	0.04	0.01	0.00	0.02	0.01	0.01	0.01
Others	0.84	1.07	1.27	0.90	1.64	1.34	1.12
Non-tax Revenue	1.93	2.36	3.27	2.08	3.48	2.70	1.98

Source: Union Budget documents, O/o CGA

Committed towards disinvestment but dependent on external factors

3.15 Apart from the tax and non-tax revenue of the Union Government, non-debt capital receipts, which comprise recovery of loans and advances, and disinvestment receipts, have evolved as an important component of the non-debt receipts for the Union Government. During FY15 to FY23 (as of 18 January 2023), an amount of about ₹4.07 lakh crore has been realised as proceeds from disinvestment through 154 transactions using various modes/instruments. This includes ₹3.02 lakh crore realised from minority stake sale and ₹69,412 crore[3] realised from strategic disinvestment transactions (in 10 CPSEs - HPCL, REC, DCIL, HSCC, NPCC. NEEPCO, THDC, Kamrajar Port, Air India and NINL).

3.16 The pandemic-induced uncertainty, the geopolitical conflict, and the associated risks have posed challenges before the plans and prospects of the government's disinvestment transactions over the last three years. Nevertheless, the government has reaffirmed its commitment towards privatisation and strategic disinvestment of Public Sector Enterprises by implementing the New Public Sector Enterprise Policy and Asset Monetisation Strategy. Out of the budgeted amount of ₹65,000 crore for FY23, 48 per cent has been collected as of 18 January 2023.

Performance of Union Government Expenditure

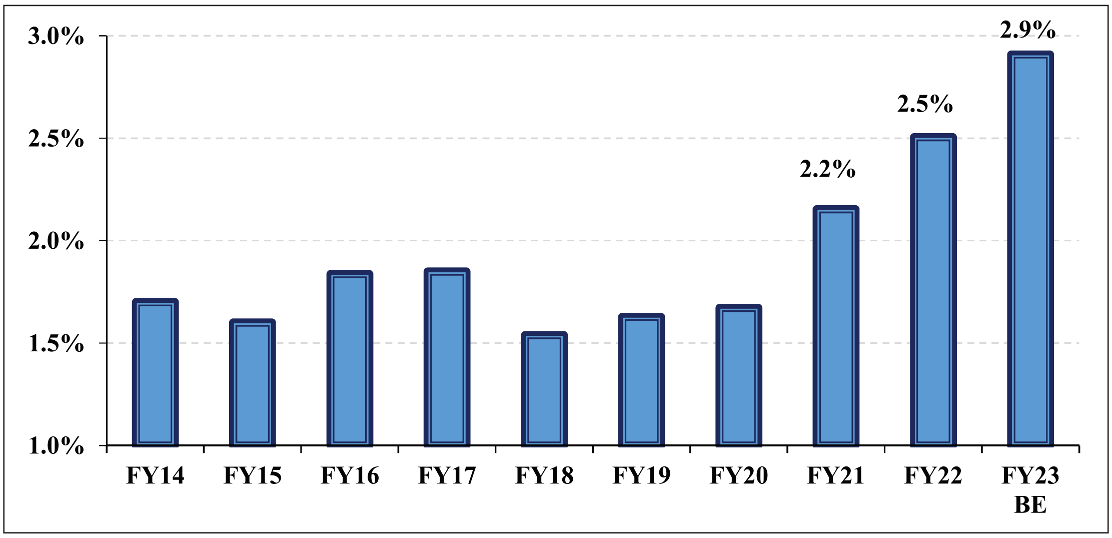
Pragmatic expenditure policy of re-prioritisation

3.17 Last few years have underlined the importance of countercyclical fiscal policy measures to support the economy during a crisis. The pandemic mandated additional expenditure requirements during FY21. The total expenditure of the Union Government in FY21 rose to

[3]This amount does not include Rs. 12,100 cr received as Enterprise Value for NINL transaction as Government of India didn't have any direct equity in this Joint Venture of Central and State PSEs.

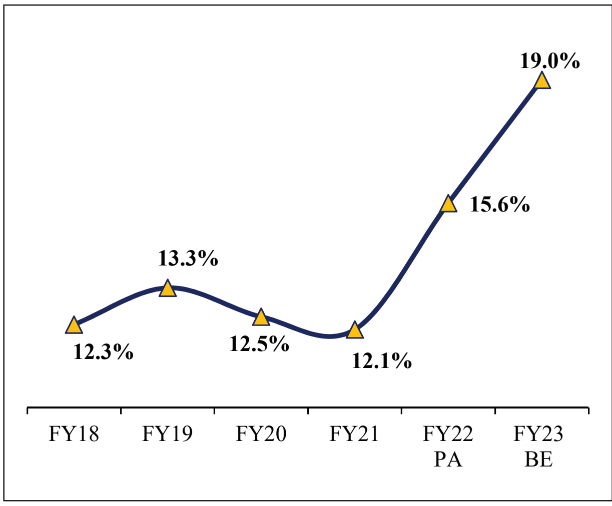
17.7 per cent of GDP, higher than the previous 5-year average of 12.8 per cent of GDP (Annexe 1: Table 2). The government adopted a pragmatic approach of increasing its expenditure in a calibrated way. Upon ensuring the basic safety nets for the vulnerable, the emphasis of the Government expenditure shifted to productive domestic capital expenditure. In the subsequent year, FY22, the total Union Government expenditure was brought down to 16 per cent of GDP (PA), and a more significant proportion of this accrued to capital expenditure (Figure III.8). The capital expenditure by the Centre has steadily increased from a long-term average of 1.7 per cent of GDP (FY09 to FY20) to 2.5 per cent of GDP in FY22 PA. It is further budgeted to increase to 2.9 per cent of GDP in FY23. (Figure III.7). This highlights an improvement in the quality of Government expenditure over the years.

Figure III.7: Increasing Union Government capital expenditure to GDP ratio



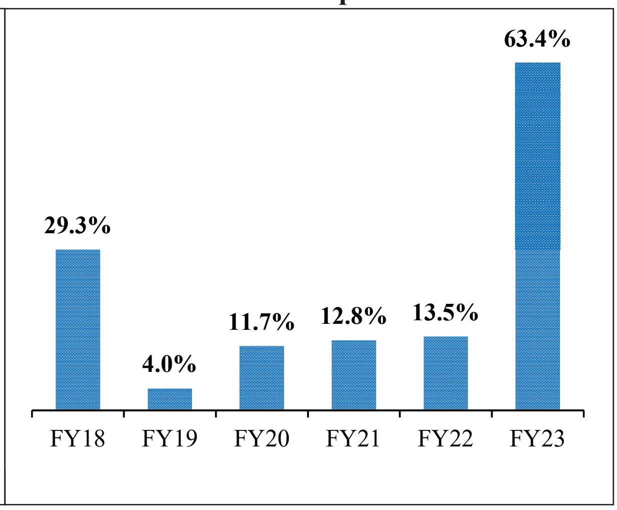
Source: Previous Economic Surveys, Union Budget documents, O/o CGA

Figure III.8: Rising share of Capital Expenditure in Total Expenditure of the Union Government



Source: Union Budget documents, O/o CGA

Figure III.9: High growth in capital expenditure of the Union Government during the April-November period



Source: O/o CGA

Capex-led growth to bring back animal spirits and manage debt levels

3.18 In absolute terms, the Government of India had budgeted an unprecedented ₹7.5 lakh crore of Capital Expenditure for FY23, of which more than 59.6 per cent has been spent from April to November 2022. During this period, capital expenditure registered a YoY growth of over 60 per cent, much higher than the long-term average growth of 13.5 per cent recorded in the corresponding period from FY16 to FY20 (Figure III.9).

3.19 The Government's thrust on Capital expenditure, particularly in the infrastructure-intensive sectors like roads and highways, railways, and housing and urban affairs, has longer-term implications for growth (Table III.4). While on the one hand, capital expenditure strengthens aggregate demand and crowds-in private spending in times of risk aversion; it also enhances the longer-term supply-side productive capacity. With early signs of a rebound in private sector investments in recent months, capital expenditure has played its role (details in chapter 1). To push for enhancing Capex from all directions, the Centre announced several incentives to boost states' capital expenditure in the form of long-term interest-free loans and capex-linked additional borrowing provisions.

Table III.4: Centre's Capital expenditure focussed on infra-related sectors

	BE FY23	April-Nov 2022	April-Nov 2021	YoY growth
			₹ lakh crore	(Per cent)
Road Transport and Highways	1.88	1.49*	0.74	102.10
Railways	1.37	1.15	0.65	76.65
Defence Services (capital outlay)	1.52	0.73	0.73	0.88
Transfer to States	1.12	0.43	0.08	438.54
Telecommunications	0.54	0.25	0.03	692.43
Housing and Urban Affairs	0.27	0.11	0.17	-32.47
Atomic Energy	0.14	0.09	0.06	47.50
Defence (Civil)	0.08	0.05	0.04	22.13
Police	0.11	0.05	0.03	53.22
Space	0.07	0.02	0.04	-48.74
Health and Family Welfare	0.06	0.01	0.02	-16.33

Note: * of which ₹1.44 lakh crore is on account of Inter Account Transfer to Reserve Funds from the Capital Section.
Source: Union Budget documents, O/o CGA

Geopolitical developments stretched the Revenue Expenditure requirements

3.20 The significant components of the Centre's revenue expenditure include Interest payments, major subsidies, salaries of Government employees, pensions, defence revenue expenditure, and transfers to States (Table III.5). A substantial portion of the Centre's revenue expenditure is committed and allows limited flexibility in creating additional fiscal headroom if required. However, re-prioritising expenditure and rationalising subsidies are essential tools to stimulate aggregate demand and fulfil redistributive imperatives.

Table III.5: Major Items of Revenue Expenditure by Union Government

Items	FY18	FY19	FY20	FY21	FY22 PA*	FY23 BE
						(in ₹ Lakh crore)
Revenue Expenditure of which	18.79	20.07	23.51	30.84	32.01	31.95
a. Salaries (pay & allowances)	1.94	2.11	2.28	3.34	3.67	4.10
b. Pensions	1.46	1.6	1.84	2.08	1.99	2.07
c. Interest payment	5.29	5.83	6.12	6.80	8.05	9.41
d. Major subsidies	1.91	1.97	2.28	7.08	4.46	3.18
e. Defence Services	1.86	1.96	2.08	2.06	2.29	2.33

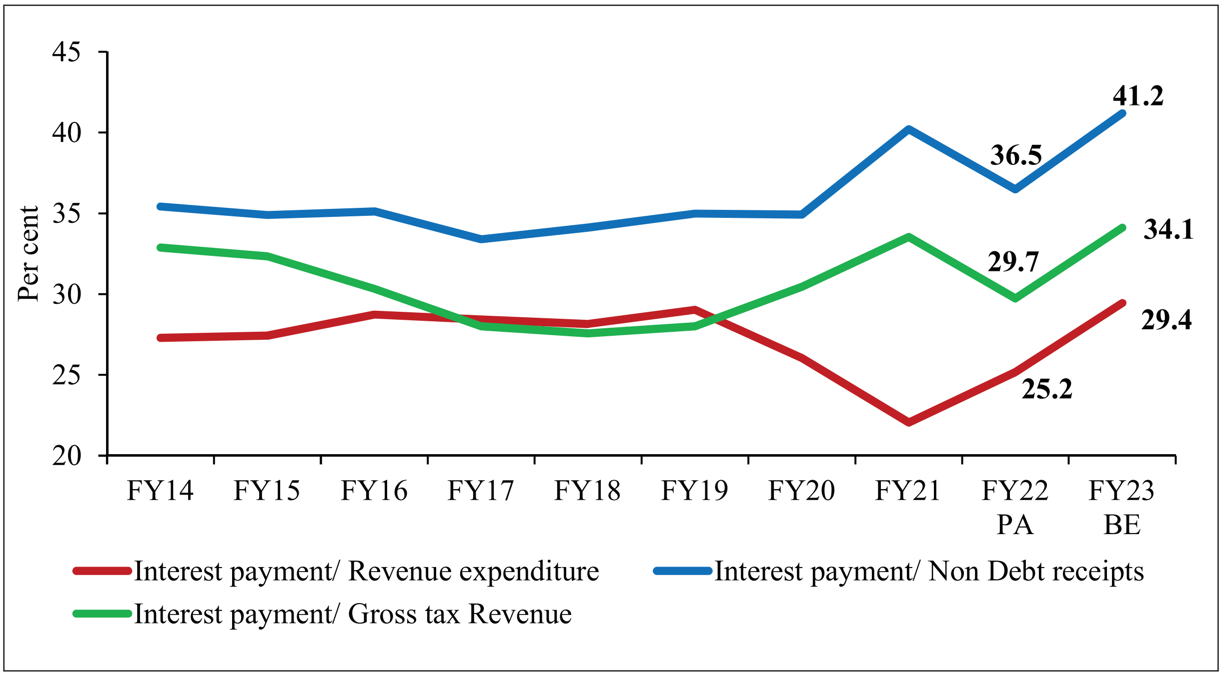
Note: Salaries for FY22 are Revised estimates
Source: Union Budget documents, O/o CGA

3.21 With the winding up of the pandemic-related support, the revenue expenditure of the Union government was brought down from 15.6 per cent of GDP in the pandemic year FY21 to 13.5 per cent of GDP in FY22 PA (Annexe 1: Table 2). This contraction was led by a reduction of the subsidy expenditure as the economy recovered from the pandemic. The subsidy expenditure was brought down from 3.6 per cent of GDP in FY21 to 1.9 per cent of GDP in FY22 PA. It was further budgeted to reduce to 1.2 per cent of GDP in FY23.

3.22 Due to the sudden outbreak of geopolitical conflict resulting in higher international prices for food, fertiliser and fuel, there was a higher food and fertiliser subsidy requirement for supporting the people and ensuring macroeconomic stability. Around 94.7 per cent of the budgeted expenditure on subsidies has been utilised from April to November 2022. In the first batch of Supplementary Demands for Grants for FY23, the Union Government has sought an additional ₹80,000 crore for the expenditure towards food subsidy and additional allocation under Pradhan Mantri Garib Kalyan Anna Yojana (PMGKAY) and ₹1.09 lakh crore for fertiliser subsidy required during the year. As a result, the revenue expenditure from April to November 2022 has grown by over 10 per cent on a YoY basis, higher than the growth noted in the corresponding period last year (Table III.1).

3.23 Another major component of revenue expenditure, interest payments, had maintained a stable ratio of non-debt receipts and revenue expenditure during the pre-pandemic years (Figure III.10). Higher resource requirements and lower revenue collections during the pandemic resulted in higher borrowings by the Union Government. Interest payments as a proportion of receipts went up after the pandemic outbreak. However, in the medium term, as we move along the fiscal glide path, buoyancy in revenues, aggressive asset monetisation, efficiency gains, and privatisation would help pay down the public debt, thus bringing down interest payments and releasing more monies for other priorities.

Figure III.10: High-interest payments as a per cent of receipts to be brought down through varied initiatives for resource mobilisation



Source: Union Budget documents, O/o CGA

3.24 It is evident from this overview of the Union Government finances that the additional expenditure needs of the Centre arising during the current year are expected to be fulfilled by the more-than-anticipated revenue collections. Thus, it is expected that reaching the budget estimate for the fiscal deficit during FY23 will not be a concern for the Union Government. With resilient economic growth, continued revenue buoyancy, and careful expenditure management over the medium run, the Union Government will be on track with the fiscal path outlined by the Medium-Term Fiscal Policy Statement. Moreover, the budgetary reforms introduced by the Union Government in the last few years will support attaining the fiscal policy targets (Box III.2).

Box III.2: Major reforms in the Union budget over the last few years

A transparent, comprehensive and realistic budgetary process enables better fiscal management.[4] This section discusses some of the major governance reforms introduced in the Union Budget over the last few years that have resulted in greater efficiency in public spending.

1. Improved fiscal transparency and realistic revenue assumptions in the Budget

The Union Government has accorded the highest priority to improving transparency in its financial statements and accounts by bringing below-the-line expenditures above the line. The Extra-Budgetary borrowings of the Union Government were brought down from ₹1.48 lakh crore in FY20 and ₹1.21 lakh crore in FY21 to ₹750 crore in FY22 (RE). No Extra Budgetary Resources were estimated for FY23 in the Budget.

[4] Section 3- Budget preparation - Guidelines for Public Expenditure Management (IMF, 1999)- https://www.imf.org/external/pubs/ft/expend/guide3.htm

In addition to cleaner fiscal accounting, Budget 2022 based its revenue projections on realistic assumptions, thus providing a buffer to the government in an uncertain global environment. These measures credibly demonstrate the government's commitment to sound fiscal management and provide an adequate buffer to deal with global challenges.

2. Discontinuation of Plan-Non plan classification[5]

The Budget FY18 discontinued having Plan and Non-Plan classifications of Government expenditure. The reform gave a greater emphasis to the Revenue and Capital classification of Government expenditure. Over the years, a broad understanding had been that Plan expenditures were good and Non-Plan expenditures were bad, resulting in skewed allocations in the Budget. The reform enabled effective planning and allocation of resources in the Budget.

3. Merger of railway Budget with the Main Budget[6]

The railway budget was merged with the Union Budget from FY18. The reform gave a holistic picture of the government's financial position. The initiative envisaged facilitating multimodal transport planning between highways, railways and inland waterways, which has been strengthened in the subsequent years through Gatishakti.

The reform has helped to enhance the efficiency of resources for both Railways and the Union Government. While the merger has exempted Railways from paying dividends to the Government Revenues, it allows the Ministry of Finance to have a greater elbow room at the mid-year review for better allocation of resources. It has also enabled the Ministry of Finance to ensure a coherent emphasis on capital expenditure across sectors in recent years.

4. Shifting the date of the Budget to 1 February

The date of the Budget was advanced to 1 February from the Budget FY18. The advancement of Budget presentation by a month has paved the way for early completion of the Budget cycle. It has also enabled the Ministries to ensure better planning and execution of schemes from the beginning of the financial year.

Overview of State Government Finances

Performance of State finances

3.25 State Governments improved their finances in FY22 after being adversely impacted by the pandemic in FY21. The combined Gross Fiscal Deficit (GFD) of the States, which increased to 4.1 per cent of GDP in the pandemic-affected year, was brought down to 2.8 per cent in FY22 PA. Given the geopolitical uncertainties, the consolidated GFD-GDP ratio for States has been budgeted 3.4 per cent in FY23 (Figure III.11). However, the States' monthly fiscal Accounts data released by O/o CAG shows that from April- November 2022, the combined borrowings of the 27 major states have just reached 33.5 per cent of their total budgeted borrowings for the year. (Figure III.12)

[5]https://pib.gov.in/newsite/PrintRelease.aspx?relid=136996
[6]https://pib.gov.in/newsite/PrintRelease.aspx?relid=153672

Figure III.11: Consolidation of States' Deficits as per cent of GDP

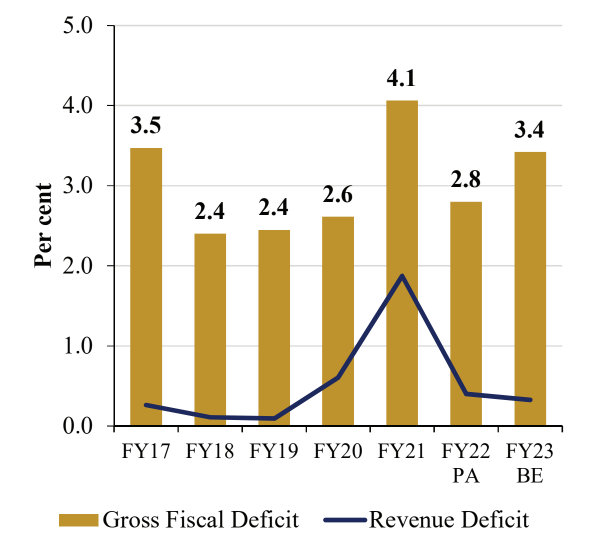
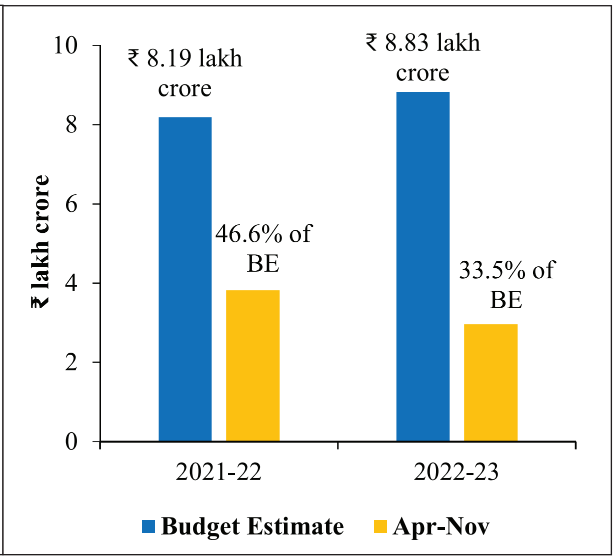


Figure III.12: Lower States' Combined Fiscal deficit during April-November



Source: RBI Study of State Budgets Jan 2023, O/o CAG
Note: Figure 12 includes data for 27 states

3.26 It is pertinent to note that states had unutilised borrowing limits during the last three years. Given the resource constraints of state governments, the Centre enhanced the net borrowing ceilings (NBC) for States to 5 per cent of GSDP in FY21, 4 per cent of GSDP in FY22, and 3.5 per cent of GSDP in FY23.

3.27 As per FY23 Budget Estimates of the State Governments, the States' combined own Tax revenue and own Non-Tax revenue were anticipated to grow at 17.5 per cent and 25.6 per cent, respectively, over FY22 RE. This growth is a continuation of the buoyancy momentum observed in the FY22 RE. On the expenditure side, revenue and capital expenditures in FY22 BE were envisaged to grow at 10.4 per cent and 16 per cent, respectively, over FY22 RE. The RBI Study on State Finances highlights that the Capital outlay, a part of the capital expenditure, has recorded a higher growth in Provisional Actuals than that estimated in the Revised estimates. The capital outlay of States grew by 31.7 per cent in FY22 PA. This increase is attributable to strong revenue buoyancy and the support provided by the Centre in terms of advance releases of payments to the states, GST compensation payments, and interest-free loans. The Centre's initiatives to support State finances are discussed in the forthcoming sections.

Cooperative fiscal federalism drives a well-targeted fiscal policy

Transfer from Centre to States

3.28 Transfer of funds to the States comprises the share of States in Union taxes devolved to the States, Finance Commission Grants, Centrally Sponsored Schemes (CSS), and other transfers. Total transfers to States have risen between FY19 and FY23 BE (refer to Table III.6).

Table III.6: Details of transfers from Centre to States (other than devolution to States)

	FY19	FY20	FY21	FY22 RE	FY23 BE
					(in ₹ lakh crore)
Centrally Sponsored Schemes	3.0	3.1	3.8	4.2	4.4
Finance Commission Grants	0.9	1.2	1.8	2.1	1.9
Other Grants/Loans/Transfers	0.9	2.0	1.9	2.3	3.0

Source: Union budget documents

3.29 The Finance Commission had recommended allocation of an amounting to ₹1.92 lakh crore for FY23 in respect of post-devolution revenue deficit grants, grants to local bodies, health sector grants, and disaster management grants under Article 275 of the Constitution. The details of the grants released during the current year may be seen in Table III.7 below.

Table III.7: Allocation of grants to the State Governments as recommended by the 15th FC

S/No.	Components	Allocation FY23	Amount released (as on 22 November 2022)
			(in ₹ crore)
1	Post Devolution Revenue Deficit Grant	86,201	57,467
2	Disaster Management Grand (Union Share)	23,294	10,976
3	Local Bodies Grants	69,421	28,609
4.	Health Sector Grants	13,192	275
	Grand Total	**1,92,108**	**1,61,230**

Source: Department of Expenditure

Supporting the GST compensation payments during crisis

3.30 Recognising the importance of a well-targeted fiscal policy by national and sub-national governments, the Union Government has taken consistent steps to support the state finances and incentivise States to move forward on the reforms agenda. To meet the shortfall in GST compensation for States, the Government, in addition to the release of regular GST compensation from the Fund, borrowed ₹ 2.69 lakh crore during FY21 and FY22 and passed it on to States on a back-to-back basis. Moreover, the cess payments and tax devolution instalments to the States were frontloaded to give them early access to funds. During FY23, the Government of India released ₹1.16 lakh crore towards the total GST compensation payable to States up to 30 June 2022 (as of 25 November 2022). Even though the total Cess collection until November 2022 was insufficient to make this entire payment to the States, the Centre released the balance from its resources. Box III.3 discusses the impact of GST on the flow of resources to the states.

Box III.3: GST and the flow of resources to states

The last five years of experience with GST have seen several rounds of policy debates around rate rationalisation, simplification of return filing, compensation cess levies on products, compensation payments to states etc. One pertinent question that has not been carefully studied is the impact of GST on the flow of resources to the states. While comparing the total fiscal resources accruing to States in the pre and post-GST regimes, it is essential to measure the relative performance of taxes vis-à-vis the performance of the economy. In the pre-GST regime, when the economy grew at 11.5 per cent nominally, the total fiscal resources accruing to States from the Central and state taxes subsumed in GST (including devolution) grew at 11.1 per cent. It implied a buoyancy of 0.97 (See table 3A).

Table 3A- Pre-GST period - Total fiscal resources to States from taxes subsumed in GST (including devolution)

	FY13	FY14	FY15	FY16	FY17	CAGR (FY17 over FY13)
					₹ lakh crore	
State taxes subsumed in GST						
States taxes subsumed in GST	3.22	3.48	3.73	4.41	4.41	
Central taxes subsumed in GST	1.66	1.90	2.02	2.48	3.14	
Devolution factor	0.32	0.32	0.32	0.42	0.42	
Total fiscal resources to States from taxes subsumed in GST	3.75	4.08	4.38	5.46	5.73	11.1%
Nominal GDP	99.44	112.34	124.68	137.72	153.92	11.5%
Pre-GST buoyancy of revenue from taxes subsumed in GST accruing to states						0.97

In the post-GST period, total fiscal resources accruing to the states from the GST (including devolution from the Centre's GST) exhibited a buoyancy greater than that in the pre-GST period (Table 3B). This performance is especially noteworthy, considering the reduction of the effective weighted average GST rate from 14.4 per cent at the time of inception to 11.6 per cent in 2019 (RBI).

Table 3B- Post-GST period - Total fiscal resources to states from the GST system (including devolution)

	FY19	FY20	FY21	FY22	FY23*	CAGR (FY23 over FY19)
					₹ lakh crore	
CGST collections	2.02	2.27	2.10	2.69	3.14	
SGST collections	2.79	3.09	2.73	3.44	3.98	
IGST collections	5.99	5.87	5.66	7.62	9.40	
GST compensation paid for the year	0.85	1.66	1.68	0.69	0.35	
Back-to-back loans			1.10	1.59		

	FY19	FY20	FY21	FY22	FY23*	CAGR (FY23 over FY19)
Total fiscal resources to states from the GST system*						
(1) SGST + IGST for states + Devolution from Centre’s GST	7.89	8.21	7.61	9.96	11.95	10.9%
(2) SGST + IGST for states + Devolution from Centre’s GST + Compensation	8.74	9.87	9.29	10.65	12.30	8.9%
(3) SGST + IGST for states + Devolution from Centre’s GST + Compensation + loans	8.74	9.87	10.39	12.24	12.30	**8.9%**
India Nominal GDP	189.00	200.75	198.01	236.65	273.09	9.6%
Post-GST buoyancy of GST revenues accruing to states (excluding compensation/ loans)						1.13

Note: (a) The devolution factor is taken as 0.32 from FY13 to FY15; 0.42 from FY16 to FY20; and 0.41 from FY21 onwards, as per the recommendation of the respective Finance Commission.
(b) IGST for States is taken as 50% of total IGST collection. State's share in Centre's GST is arrived by multiplying the devolution factor with CGST and Centre's IGST share.
(c) The collection for FY23 have been extrapolated based on the average collections from May to Dec 2022.
(d) The GST collections used are gross collections, including domestic supplies and import. However, with only the GST collections through domestic supplies, the post GST buoyancy is still greater than 1 (=1.05).

In addition to the regular stream of revenues from GST, a compensation was also provided to the states in the post-GST period. Since GST was a new tax regime, the compensation scheme was designed to safeguard the states for any difference in the new versus the old tax regime by ensuring steady revenue growth of 14 per cent per annum for five years. The compensation arrangement was also meant to help states ride out the differences in the inter-state distribution of GST. It is pertinent to note here that the compensation system was not envisaged as a buffer to the state's revenues in the eventuality of a fall in tax revenues resulting from a collapse in economic growth.

Nevertheless, the incidence of the pandemic has highlighted the relevance of GST Compensation as a buffer to the States' revenues. During FY21, revenues for Centre and states were adversely affected due to the economic contraction. The compensation requirement by the states increased substantially amidst a decline in the CGST and the compensation cess collections. Despite having limited fiscal resources in the middle of a crisis, the Centre borrowed funds and passed them on to States on a back-to-back loan basis, in addition to the release of regular GST compensation. These loans will be repaid from future inflows into the GST Compensation Cess Fund and hence are not a burden on the states.