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Editorial: A road map for renewal

Introduction:

The Economic Survey, a statutory document tabled in Parliament, is meant to be a scorecard of the economy for the current fiscal year. But over the years, it has transformed into a sourcebook for data and policy analysis. Big Data has been mined to shed light on the economy.

New facts on the Indian Economy mentioned in Economic Survey, 2018

Increase in Tax payers:

- There has been a large increase in registered indirect and direct tax payers
- A 50 % increase in unique indirect tax payers under the GST compared with the pre- GST system.
- Similarly there has been an increase in income tax filers since November 2016.

Formal non-agricultural payroll:

- Percentage of non-farm employment is much greater than believed.

State's property in correlation with Trade:

- State that export more internationally, and trade more with other states, tend to be richer.
- But the correlation is stronger between prosperity and international trade.

Export Structure:

- India's firm export structure is substantially more egalitarian and is more diversified than in other large countries.
- Top 1 percent of Indian firms account for 38 percent of exports. In other countries, they account for a substantially greater share.
- It is promising to note the important role of small and medium enterprises in industrial employment and exports.

Preference for son leads to skewed sex ratio

- Indian society exhibits strong preference for son.
- Survey mentions that Parents continue to have children until they get the desired no of sons. This kind of fertility-stopping rule leads to skewed sex ratios.

Litigation in Tax disputes

- There is substantial avoidable litigation in the tax arena which government action could reduce.
- The tax department's petition rate is high even though its success rate in litigation is low and declining.
- According to Survey, Only 0.2 percent of cases accounted for 56 percent of the value at stake
- About 66 percent of pending cases (Each less than Rs. 10 Lakh) accounted for only 1.8 percent of the value at stake.

Growth slowdowns are preceded by investment slowdowns

- Cross-country experience shows that growth slowdowns are preceded by investment slowdowns but not necessarily by savings slowdowns.
- To re-ignite growth, raising investment is more important than raising saving.

- There is economic evidence suggesting competitive exchange rates are more important for export-led growth.

Lack of direct taxation powers to states and local governments

- ✓ Own direct tax collections by Indian states and local governments are significantly lower than those of their counterparts in the other federal countries.
- ✓ The share is low relative to the direct taxation powers they actually have.

Evidence of Climate change in the country

- The footprint of climate change is evident and extreme weather adversely impacts agricultural yields.
- Unirrigated ones would have twice the impact than irrigated ones.

What are major reforms undertaken over the past year?

- ✓ The Goods and Services Tax (GST) was launched in July, 2017. The policy of such scale, scope and complexity affected the informal sector. The transition encountered challenges of policy, law and IT systems.

- ✓ Decisive action through 4 R's (Recognition. Resolution, Recapitalization and Reforms) was taken to tackle Twin balance sheet challenge.

- ✓ The new Indian Bankruptcy Code (IBC) has provided a resolution framework for corporates to clean-up their balance sheets and reduce debts.

- ✓ Government announced a large recapitalization package to strengthen the balance sheets of PSBs which are reeling under the pressure of NPAs.

- ✓ These reforms would resume spending and enable banks to lend to critical but currently-stresses sectors of Infrastructure and Manufacturing.

How have been macroeconomic developments this year marked by 'swings'?

In the first half,

- ✓ India's economy temporarily "**decoupled**," that means, India's growth had been accelerating until early 2016, when Growth in other countries was decelerating. But then the converse happened. The world economy witnessed a gradual recovery, but India's GDP growth decelerated even as India remained the second-best performer amongst major countries.

- ✓ Reasons for the swings are demonetization, Transformation into new GST regime, rising real interest rates, the Twin Balance Sheet challenge, and sharp falls in certain food prices that impacted agricultural incomes.

In the second half,

- Indian economy witnessed signs of revival as economic growth improved and global economic recovery boosted exports.
- Reflecting the cumulative actions taken by the government to improve the business climate, India jumped 30 spots on the World Bank's Ease of Doing Business rankings,

while similar actions to liberalize the foreign direct investment (FDI) regime helped increase flows by 20 percent.

However, these solid improvements coupled with negative fall outs such as higher Fiscal deficits, the current account, and inflation, reflecting in part higher international oil prices. Rising capital flows, especially into debt instruments, in liberalized FDI regime caused the rupee to strengthen, dampening both net services exports and the manufacturing trade balance Survey hints that some slippage from pre-announced fiscal deficit targets is to be expected in this pre-election Budget. The bond markets react to fiscal slippage negatively and already there is sell-off of bonds. This will lead to a rise in interest rates. The biggest loser from a higher interest rate is the biggest borrower in the system, the Government of India.

What are the broader lessons for the Indian economy going forward in the medium term?

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1. Stabilize GST implementation:

- ✓ The government will need to stabilize GST implementation to remove uncertainty for exporters, facilitate easier compliance, and expand the tax base.
- ✓ Tax-GDP ratio has to be improved to tackle macro-economic vulnerabilities w.r.t fiscal and capital accounts when the oil prices rise. The GST could help to overcome this problem with positive spill overs for macro-economic stability.
- ✓ GST council, which strengthens cooperative federalism, could be used as a platform to create a common agricultural market, integrate fragmented and inefficient electricity markets, solve interstate water disputes, implement direct benefit transfers (DBT), make access to social benefits portable across states, and combat air pollution.

1. Focus on the 4 R's

- The government will need to focus on the 4 R's, ensuring that the process of resolving the major indebted cases and recapitalizing the PSBs.

1. Resolving Tax litigation

- The total amount estimated to be locked up in tax disputes is more than ₹8.2 lakh crore.
- The Economic Survey points out that such a high rate of pendency and the huge amounts stuck in litigation are hurting India's ease of doing business.
- IBC should aim to solve Twin balance sheet problems through the expedient of transparently auctioning off stressed firms to the highest bidders.
- The decision to ban promoters of firms with non-performing loans from the IBC auctions may have been necessary to minimize moral hazard going forward.

2. Rationalise Government resources:

- A major goal of government policy has been to rationalize government resources, redirecting them away from subsidies towards public provision of essential private goods and services at low prices, especially to the poor.
- The pace and magnitude of this improvement will depend upon the extent to which increased physical availability/provision is converted into greater actual use. For instance: toilet building into toilet use, bank accounts into financial inclusion.

1. Addressing the current account vulnerability requires raising the trajectory of export growth with internationally competitiveness of manufacturing.
2. Both competitive exchange rates and open capital accounts are helpful for growth.
3. Policy design must minimise the costs wherever possible with recourse to calibrated decisions. The government will have to think very carefully on how to avoid slippage and keep bond markets optimistic.
4. State's capacity of delivery of essential services such as health and education should be enhanced by the use of the JAM (Jan Dhan—Aadhaar—Mobile) architecture, now enhanced by the Unified Payments Interface (UPI).

5. The government's target of doubling farmers' incomes consequently requires radical follow-up action, including decisive efforts to bring science and technology to farmers, replacing untargeted subsidies (power and fertiliser) by direct income support, and extending irrigation via efficient drip and sprinkler technologies.

What could be the key macroeconomic headwinds from abroad?

First, oil prices are going up. This will result into increasing import bill, growing oil subsidy burden and higher inflation. Every $10 increase in oil prices can reduce GDP growth by 0.2-0.3%. And oil prices have gone up by almost 60% in the last six months. Aggressive output cuts by Saudi Arabia (and Russia) could force oil prices even higher.

The second headwind comes from the tightening stance of the world's most influential central bank, the U.S. Fed. As rates are being tightened in the U.S., it is likely to lead to a reversal of dollar flows, which can impact India's domestic liquidity situation, the stock market, and perhaps the exchange rate.

In addition to it, there are the usual geo-political and geo-economic risks: war in the Korean peninsula; political upheaval in the Middle East; a final reckoning from China's unprecedented credit surge in the form of capital controls, slowdown in growth, and a sharply depreciating currency with consequences for the global economy.

The Global Outlook by IMF

According to the International Monetary Fund (IMF), the global economy is experiencing a near-synchronous recovery, the most broad-based since 2010.

In 2017, roughly three-quarters of countries experienced improvements in their growth rates, the highest share since 2010.

The latest World Economic Outlook (WEO) of the IMF shows global GDP growth accelerated to around 3.6 percent in 2017 from 3.2 percent in 2016, and the forecast for 2018 has been upgraded by 0.2 percentage points to 3.9 percent.

One reason why the recovery has spread around the globe is that world trade in goods and services has finally emerged from its inactivity, registering 4.7 percent real volume growth in 2017 compared with 2.5 percent in 2016.

Another reason is that commodity producers such as Russia, Brazil, and Saudi Arabia, which for the past few years been suffering from depressed prices, have benefitted from the upswing in demand.

Private investment seems poised to rebound, as many of the factors exerting a drag on growth over the past year finally ease off. Translating this potential into an actual investment rebound will depend on the resolution and recapitalization process.

Putting all these factors together, a pick-up in growth to between 7 and 7.5 percent in 2018-19 can be forecasted, re-instating India as the world's fastest growing major economy.