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- Dr. R Nagaraj

REAL ESTATE: The Impact of RERA 2016 & Demonetization

- Dr. Manas Paul & Akshay Deepak

Budgeting for Inclusive Growth in The Current Macroeconomic Context

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The Case for an Expansionary Fiscal Policy

- Dr. Surajit Mazumdar

Quarterly Journal of the Bombay Chamber of Commerce and Industry Trust for Economic and Management Studies

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From the Editor's Desk

As we go to press with the current issue, economic reports published by GoI state that despite global sluggishness, the domestic economy has sustained a macroeconomic environment of relatively lower inflation, fiscal discipline and a moderate current account deficit. This is in spite of the fact that the country's economic growth is facing challenges such as subdued manufacturing, lower exports of services and lower capital expenditure. Also, in the aftermath of demonetisation this is critical to ensure that India's current favourable economic environment could be a permanent one.

According to the first advanced estimates released by the government, the GDP growth for FY 17 is projected to be 7.1 per cent. As far as economic indicators are concerned the agriculture sector showcased enhanced performance due to a favourable monsoon, CPI inflation has remained largely steady with average rate 5%, IIP has been volatile but GFCE as a percentage of GDP has been higher and also the FII inflows in the second half of this fiscal witnessed low inflows following unfavourable signals as a result of the U.S elections.

In this current issue we have made an attempt to capture some of those issues and their probable impact on our economy.

We hope you enjoy reading this information packed and insightful issue.

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Special Theme

Economic Reforms and Manufacturing Sector Growth

Need for Reconfiguring the Industrialisation Model

*R Nagaraj**

Summary

Manufacturing output grew 7%–8% annually since 1991, with a marked improvement in the variety and quality of goods produced. Yet, its share in gross domestic product has practically stagnated, with a sharp rise in import intensity. Liberal (or market-friendly) policies were expected to boost labour intensive exports and industrial growth. Why did the manufacturing sector fail to realise these goals? It is widely believed that India needs to "complete" the reform agenda to realise its potential. Critically examining such a view, it is suggested that the long-term constraints on industrialisation perhaps lie in poor agricultural productivity and inadequate public infrastructure. Further, there is a need to re-imagine the role of the development state to realise goals, as the experience of all successful industrialising nations suggests.

Introduction

Over a quarter century of market-oriented (or liberal, or free market) reforms (1991–2016), the manufacturing (or industrial) sector has grown annually between 7% and 8% on a trend basis (depending upon the data series chosen) (Figure [1]). The growth rate after the reforms is higher than in the preceding quarter century, but it is roughly the same as in the 1980s, when the early reforms were initiated. India's share in global merchandise trade has moved up from nearly 0.5% in 2000 to 1.5% by 2015, and the share of services exports rose from 1% to 3% during the same period (Figure [2]).

Industrial production has diversified with perceptible improvements in the quality and variety of goods produced with growing domestic competition. Yet, the manufacturing (or industrial) sector's share has stagnated at about 14%–15% (26%–27%) of gross domestic product (GDP) after the reforms (Figure[3]). Though India has avoided deindu strialis-ation— defined as a decline in the manufacturing (industrial) sector's share in GDP, or share in workforce—it stares at a quarter century of stagnation, in contrast to many Asian economies that have moved up the technology ladder with a rising share of manufacturing

I sincerely thank Dennis Rajakumar for providing me with concorded time series Annual Survey of Industries data for the paper.

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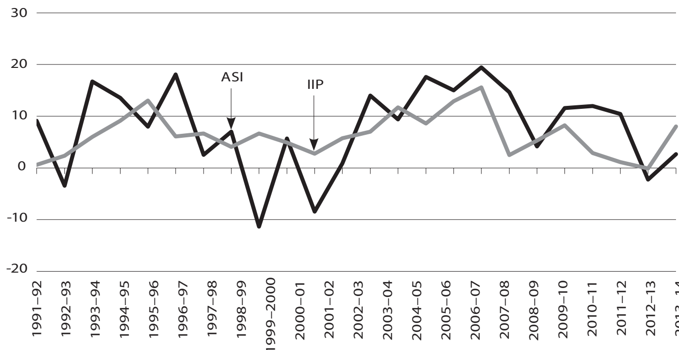
in domestic output and global trade (Rodrik 2015).

However, over a longer period, Indian industry has regressed. The telling evidence of it is a comparison with China. Around 1950, both the large Asian giants were roughly at the same level of industrialisation (or lack of it); if anything, India had an edge (Raj 2006; Kumar 1988). By 2010, however, China became world's second largest manufacturing nation, and India ranked 10th, producing one-third or one-fourth of China's industrial output (at the current market exchange rate) (Figure 4, p 63).

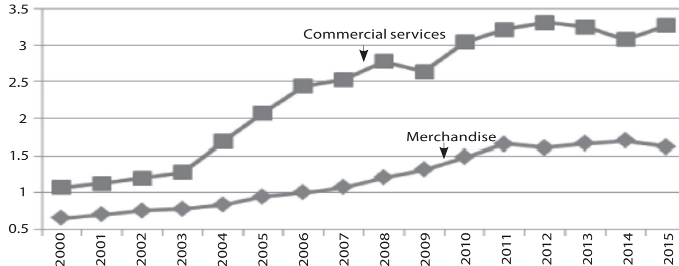
The reforms were built on the initial success in delicensing and import liberalisation (that is, a switch from quotas to tariffs) in the 1980s. However, deepening of the reforms since the 1990s—as part of the broader stabilisation and structural adjustment programme—meant a clear departure from the state-led domestic-oriented, capital goods-focused, "heavy" industrialisation strategy, towards a market-friendly regime, as advocated by most mainstream economists and development agencies, such as the World Bank (as evident in its official publication, The East Asian Miracle, 1993). The reforms were initially underwritten by structural adjustment loans from the Bretton Woods institutions, conditional upon implementation of the policy changes (as against World Bank's predominant interest in project finance). Though perhaps modest, these loans signalled to global capital markets and international business the Bretton Woods institutions' end or sement of the shift in India's economic policy.

Figure 1: Manufacturing Sector Growth Rate —by ASI and IIP



Source: CSO and RBI's Handbook of Statistics on Indian Economy

Figure 2: India's Share in Global Trade

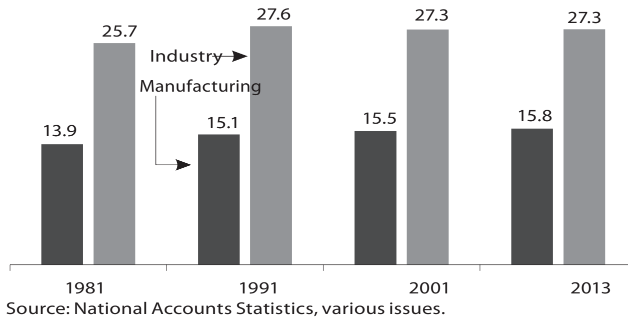


Source: Veeramani (2016)

Jagdish Bhagwati, the most ardent and long-standing critic of India's planning, succinctly summarised what the reforms really meant, when he said:

The main elements of India's policy framework that stifled efficiency and growth until the 1970s, and somewhat less so during the 1980s as limited reforms began to be attempted, and whose surgical removal is, for the most part, the objective of the

Figure 3: Share of Manufacturing and Industry in GDP



Source: National Accounts Statistics, various issues.

substantial reforms begun in mid-1991, are easily defined. I would divide them into three major groups:

(1) Extensive bureaucratic controls over production, investment and trade;

(2) Inward-looking trade and foreign investment policies;

(3) A substantial public sector, going well beyond the conventional confines of public utilities and infrastructure. (Bhagwati 1993: 46)

In other words, to put it more graphically using Bhagwati's picturesque imagery, the reforms meant making a bonfire of industrial investment and output controls, or ending the much criticised permit–licence raj. However, in practice, the speed and scope of the reforms was gradual—slow by international standards, but pretty rapid by domestic yardsticks—and they were undertaken by trial and error, regardless of the political dispensation at the helm.

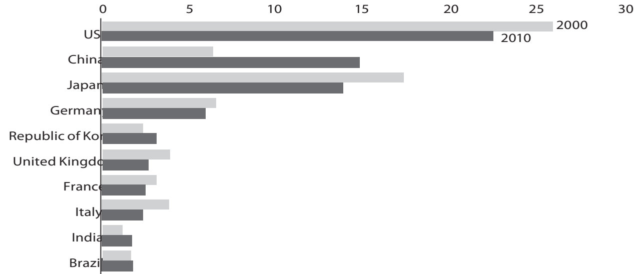
The reforms, though initially centred on industry and trade, culminated in encompassing financial globalisation in the last decade, when India got enmeshed in the global economic cycles of boom and bust.[2] The public sector was rolled back even within the "conventional confines of utilities and infrastructure" by allowing private and foreign capital in these industries. India surely rode the boom during its "dream run" for five years from 2003 to 2008, to clock an unprecedented annual economic growth of about 9%, to be counted as among the world's fastest growing large economies (Nagaraj 2013).

If China came to be known as the world's factory, India was reckoned, albeit briefly, as its back office. After the global financial crisis, as with the rest of world, India's boom went bust, with industrial deceleration, rising import dependence, and growing short-term capital inflows (or, simply, hot money) financing the balance of payments deficit.

After a quarter century of market-oriented reforms, why did India fail to emulate (or catch up with) the Asian economies to cement its reputation as a successful industrial nation with rising manufactured exports? Perhaps, with booming services exports, India dreamt of skipping the industrialisation stage to be counted as the world's back office, leveraging its large "educated" English-speaking workforce, and ignoring outsourcing services' narrow employment base domestically, and even the slender market segment it was tied to in the financial services sector in the United States (US).

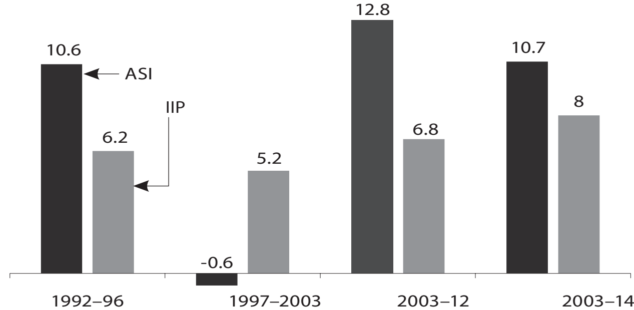
We are now back to the drawing board, trying to configure how to reindustrialise, given India's persistent economic backwardness (with half of its workforce still

Figure 4: World's Top 10 Manufacturing Nations in 2000 and 2010



Source: UNIDO's International Yearbook of Industrial Statistics, 2012

Figure 5: Manufacturing Sector Growth as per ASI and IIP



Source: CSO and RBI's Handbook of Statistics on Indian Economy

engaged in low productive agriculture, and over two-thirds of the population still living in villages) with bleak export prospects, and fickle capital inflows financing its external deficit.

This is not a new question, however. The "Make in India" campaign seeking to raise the manufacturing sector's domestic output to 25% (Invest India nd), or, the previous regime's National Manufacturing Policy, 2011, aimed at raising the manufacturing sector's share in GDP to 25% by 2022 (Ministry of Commerce and Industry 2011) are the official efforts to grapple with the question. But, the real challenge apparently is to translate these lofty goals into actionable policies with suitable instruments. While working out the specifics of such a strategy is beyond the scope of the study, it hopes to lay out a broad framework of analysis for such an initiative. This paper critically reviews industrial performance and policy after the reforms in 1991, and seeks to address the question of how to get over the stagnation.

Industrial Trends

Over the entire period of reforms (1991– 2014), the manufacturing sector grew at an annual trend growth rate of 7.7% or 7.2% as per the Annual Survey of Industries (ASI) and Index of Industrial Production (IIP), respectively (Figure1). Evidently, the ASI recorded much wider yearly fluctuations than the IIP, which would show wide differences in the growth rates over shorter periods.[3]

From Figure 1, it is evident that the 25-year period can be subdivided into three distinct phases: 1992–96, 1997–2003 and 2003–14 (Figure 5). The first phase represents the initial euphoria of reforms, with booming output and investment in the anticipation of a virtuous cycle of faster growth and exports. However, with the expectations of a boost in demand not being realised, industrial growth decelerated. It coincided with the Asian financial crisis, bust of the dotcom bubble, and freezing of credit markets in the US in the early 2000s.[4]

The period from 2003 to 2014 represents, as mentioned earlier, the recent debtled cycle of boom and bust, perhaps and global exports (Figure 6) (Nagaraj 2013). After the global financial crash

in 2008–09, fiscal and monetary stimulus domestically and capital inflows on account of quantitative easing (QE) in the advanced economies sustained economic growth until 2011–12 (as also in many emerging market economies), giving rise to a short-lived euphoria of emerging market economies (EMEs) getting "delinked" from the advanced economies.

The industrial growth scenario after 2014 remains hazy on account of unreliable data. While the IIP shows marginal improvement, the new series of the National Accounts Statistics (NAS) reports a distinct upturn—a widely contested statistic (Nagaraj 2015) (Figure 7). The turnaround in industrial and domestic output growth rates are not supported by the trends in (i) credit growth and (ii) capacity utilisation in industry (Figure 8 and Figure 9).[5]

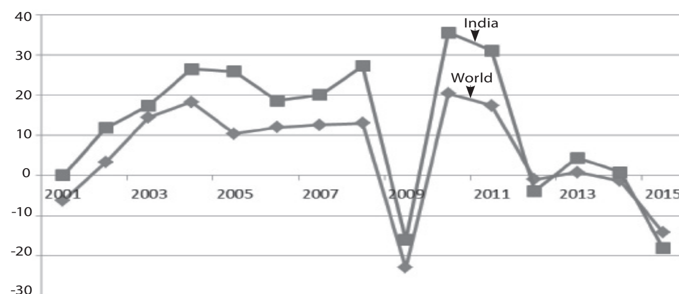
Performance During the Boom and Bust

From 1991 to 2003, industrial performance was not particularly impressive. After the initial boom until 1996, there was a nine-year period of deceleration, when the output growth was buffeted by many shocks, such as the Asian financial crisis. However, the following cycle of boom and bust (2003–14) was significant in many respects. Five years of India's dream run (2003–04 to 2007–08) were surely led by outsourcing services exports, but manufacturing growth matched the boom with a 10% annual growth rate. This was made possible by a steep rise in domestic savings, invest-ment, and capital inflows, boosting the capital formation rate to close to 40% of GDP at the peak of the boom in 2008 (Figure 10). The growth rate recovered after the financial crisis in 2008–09, but at a slower rate of 7.3% per year in the following four years until 2011–12, and decelerated rapidly thereafter.

Table 1 provides the average of annual growth rates from 2004–05 to 2013–14, as per the IIP, for usebased industrial categories. In this period, consumer durable goods and capital goods (with each weighing about 8% in the IIP) grew close to 10% per year, while consumer non-durable goods (with a weight of 21%) grew the slowest at 4.2% per year.

This was also the time when foreign firms and brand names came to dominate many markets, especially consumer durables and capital goods. The import to domestic output ratio went up quite sharply in most industries (Chaudhuri 2013). However, if indirect imports are included, the ratio would go up further.[6]

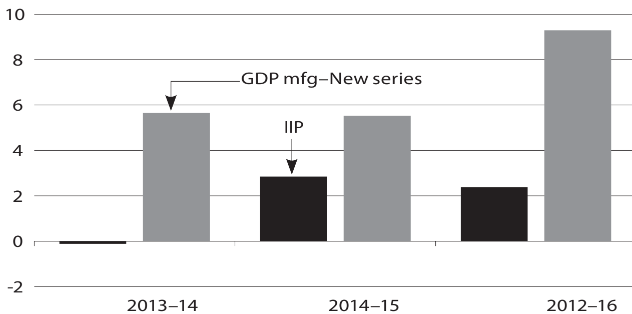
Figure 6: Annual Merchandise Export Growth Rate for India and the World



Source: Veeramani (2016)

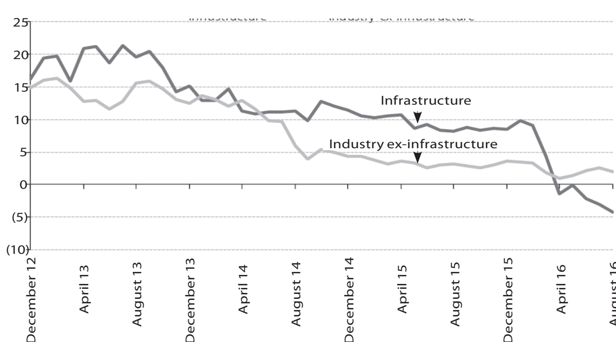
Table 1: Growth Rates by IIP's Use-based Industrial Classification, 2005–14		
Use-based Industrial Output	Weights	Average of Annual Growth Rates
Basic goods	45.68	5.2
Capital goods	8.83	9.7
Intermediate goods	15.69	4.3
Consumer goods	29.81	5.9
Consumer durables	8.46	9.8
Consumer non-durables	21.35	4.2
Index of Industrial Production (general)	100	5.7
Source: RBI's Handbook of Statistics on Indian Economy.		

Figure 7: Manufacturing Growth Rate as per IIP and New GDP Series



Source: National Accounts Statistics, various issues, and RBI's Handbook of Statistics on Indian Economy.

Figure 8: Quarterly Credit Growth to Infrastructure and Industry, 2012–16



Source: CEIC, RBI, Kotak Economic Research.

In the 2000s, two significant policies were initiated for industrialisation, namely, special economic zones (SEZs) and un-freezing of the land market for private industrial and infrastructure investment. Until then, export processing zones were set up by the public sector, and land acquisition for infrastructure was their exclusive domain. When these activities were thrown open to private and foreign capital, the results were dramatic. The land market quickly got commercialised, with easy access to domestic and international capital, and with property development acquiring primacy over industrial use of land (Levien 2012).

In practice, these policies—meant for promoting industrial exports and infrastructure—quickly became a means of acquiring scarce land, often with state support, from gullible farmers who sold their land cheap or were evicted with the state's connivance, giving rise to the term, "predatory growth" (Bhaduri 2008). This resulted in widespread political and social agitations against such policies, contributing little by way of industrial output.

Competing Explanations for the Trends

How does one understand the foregoing account of industrial performance? Many would agree that industry underperformed, but the reasons proffered for it could vary considerably. [7] By no stretch of imagination could state policy constrain

industrial decision-making any longer. With India's tariff getting reduced, and with numerous bilateral trade and investment treaties, India's openness became comparable to its Asian peers. Crucially, if the much derided permit–licence raj had held up industrial growth during the planning era, then why did industrial output and exports not zoom after the reforms?

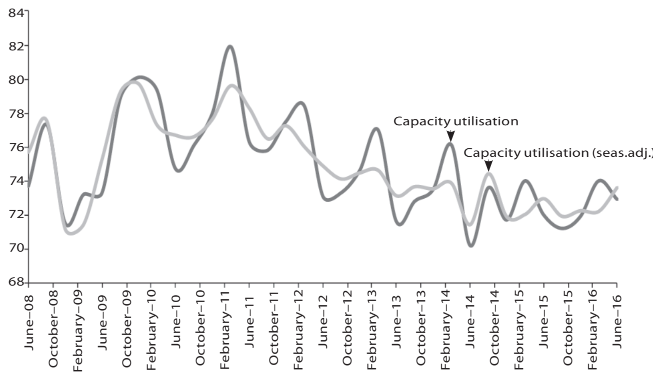
Protagonists of reforms, however, would contend that the reforms have not gone far enough or the agenda remains incomplete—with restrictions remaining on foreign direct investment (FDI) (especially in retail trade), labour market regulation (in the ability to hire and fire at will), full convertibility of capital, etc. These ar-guments seem questionable. There is no clear theoretically valid and empirically sound association bet ween pro-market reforms and growth (Rodrik 2011). There is perhaps room for critically examining what has been the outcome of the liberalisation carried out thus far.

What has India's open-door policy for FDI led to? In the last decade, the most significant variety of FDI inflow has been private equity (PE), venture capital (VC), and hedge regulated alternative investment funds that funds (HF), which are, by definition, loosely regulated alternative investment funds that are part of shadow banking. They are not even considered as FDI by the United Nations Conference on Trade and Development definition since they are not for the long-term. Quantitatively, the most important of these sources is PE funds, which, by definition, acquire existing assets and sell these after three–five years in the stock market after restructuring. These are hardly the kind of foreign capital that India needs for getting technology and acquiring industrial capability.[8] Table 2 (p 66) provides information on PE and VC inflows into India since 2005 and an illustra-tive list of projects in which they have invested during 2015. Economic implications of PE investment are that it is financing of domestic consumption using foreign debt, not productive investment.[9]

The labour market rigidity hypothesis is seriously contested; careful reviews of the literature find little support for the widely-held proposition (Kannan and Raveendran 2009; Teitelbaum 2013; Sood et al 2014). That the labour market rigidity argument holds little water now can be gauged by the recent news report that Larsen & Toubro, India's largest machinery and construction firm (turnover $16 billion) reportedly laid off 14,000 workers (11.2% of its workforce of 1.22 lakh workers) during July–September 2016 (Prasad 2016). It amply demonstrates that the "hire and fire" policy effectively rules the organised labour market today.

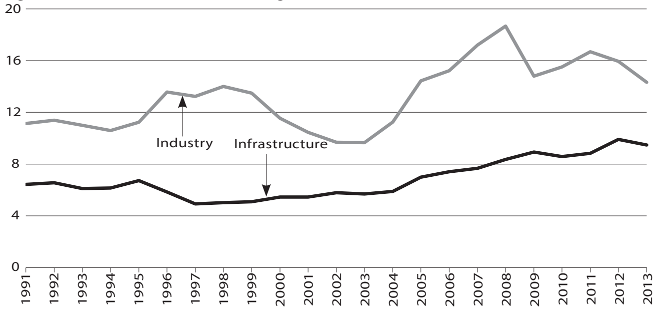
Arguably, the retrenched workers are temporary or contract workers who are not protected by labour laws, which are the bone of contention. But, the fact that such a large enterprise employs non-permanent workers in such large numbers only goes to show how the seemingly rigid laws do not apply to a growing segment of organised workers and that the laws really have no teeth. Hence, the contention that labour laws are holding up flexible and efficient use

Figure 9: Capacity Utilisation in Industry, 2008–16



Source: CEIC, RBI, Kotak Economic Research.

Figure 10: Fixed Investment as Percentage of GDP



Source: National Accounts Statistics, various issues.

of labour simply does not hold water.

Currently, policymakers are using the World Bank's "Ease of Doing Business" (EDB) as a measure of hurdles faced by entrepreneurs, and are busy trying to improve India's global ranking to attract more foreign investment. This dubious measure, both conceptually and empirically, hardly explains the foreign investment in-flows in developing countries, as evident from a World Bank research paper quoted below:

The World Bank's Ease of Doing Business reports have been ranking countries since 2006. However, do improvements in rankings generate greater foreign direct investment inflows? ... The paper shows this relationship is significant for the average country. However, when the sample is restricted to developing countries, the results suggest an improved ranking has, on average, an insignificant (albeit positive) influence on foreign direct investment inflows. ... Finally, the paper demonstrates that, on average, countries that undertake large-scale reforms relative to other countries do not necessarily attract greater foreign direct investment inflows. This analysis may have important ramifications for developing country governments wanting to improve their Doing Business Rankings in the hope of attracting foreign direct investment in-flows. (Jayasuriya 2011)

If the foregoing arguments are reasonable and evidence credible, then we should look elsewhere for the reasons of the industrial stagnation. The answer perhaps lies with the structuralist economic arguments and the long-term constraints, such as less than satisfactory or poor agriculture performance after the reforms (Figure 11). Moreover, despite gradual improvements, land productivity in agriculture continues to be a modest fraction of the global average (Figure 12).

Further, lack of adequate public infrastructure investment (as capacity creation for power generation by proxy) seems to be holding back industrial growth (Figure 13).

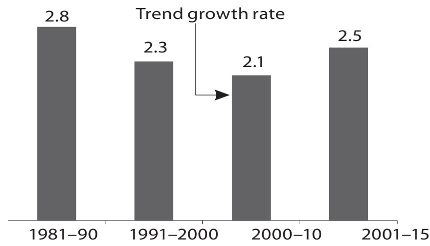


Figure 11: Agriculture Growth Rates, 1981–2015

Source: EPW Research Foundation, India times series data.

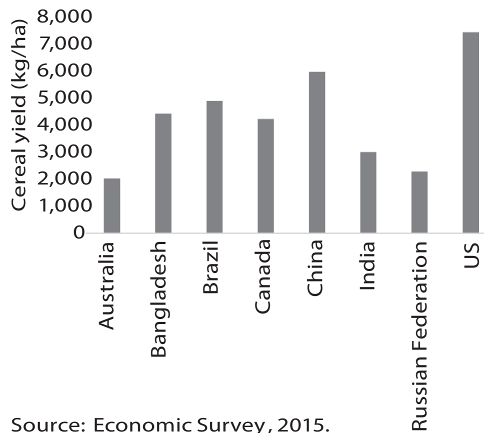
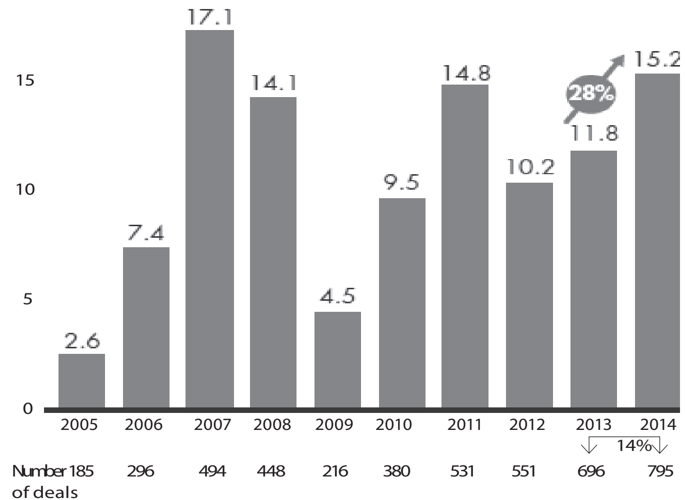


Figure 12: Average Cereal Yields in Selected Countries, 2013

Source: Economic Survey, 2015.

At the moment, in the aftermath of the global financial crisis, Indian industry is suffering from excess capacity in major industries like steel, coal and machinery, as investment rates and exports have fallen. Fixed capital formation ratio, for instance, has fallen by almost 10 percentage points, from close to 40% of GDP in 2008. As the private corporate sector is mired in debt, and the banking sector is left holding non-performing assets, there is little option but to revive public investment to boost investment and domestic output (Nagaraj 2014).

Table 2: PE Inflow since 2005 and Illustrative List of Their Investments in 2015



Source: India Private Equity Report, 2015, Bain & Company.

Need for Reconfiguring Development State

While the foregoing arguments for removing the structural constraints on industrial growth still hold, it is perhaps an opportune moment to revisit the role of state support for industrialisation. Admittedly, state intervention during the planning era (1950–80) had many shortcomings (too widely acknowledged to bear repetition), and many aspects of it may have outlived their utility. Yet, perhaps, the rush to open up markets after 1991 (under stressed macroeconomic conditions) seems to have hurt long-term industrial and trade prospects. [10] So, there seems to be a need to rebalance the equation between the state and the market keeping in view the strategic considerations.[11]

The basic arguments for industrial policy come from Nicholas Kaldor's stylised fact that faster manufacturing sector growth propels the rest of the economy following Verdoon's law of

positive externalities. In a somewhat similar vein is Paul Krugman's (1995) hypothesis of economies of locational agglomeration giving rise to positive externalities. Finally, the arguments of market failures due to information imperfections, and state intervention solving the coordination problem offer credible reasons for having an industrial policy Suzumura (1997). Moreover, the comparative Asian experience (starting with Japan to a contemporary account of China and Vietnam) offers powerful empirical arguments for industrial policy.

Three aspects of industrial and investment policies that seem to need careful attention are: (i) long-term finance, (ii) domestic research and development (R&D) efforts, and (iii) bilateral investment and trade treaties.

India seems to have a disadvantage vis-à-vis its trading partners, especially with respect to China in all these policies. As part of financial liberalisation, India turned its development financial institutions (DFIs)—such as IDBI (the Industrial Development Bank of India) and ICICI (Industrial Credit and Investment Corporation of India)—into commercial banks, resulting in shortening of loan maturity, thus constraining capital-intensive manufacturing and infrastructure financing. The domestic debt market was expected to fill the vacuum, and that has not happened (as in most industrialising countries). In response, large firms were allowed to borrow internationally even for investments in the non-traded goods sector, leading to currency and maturity mismatches, thus raising potential financial instability. China, which is still not officially granted the status of a market economy, is known to use cheap credit (including trade credit) as an instrument for penetrating international markets, especially in project exports. Commercial sources often suggest that Indian firms are perhaps unable to match the Chinese firms' commercial terms, despite producing goods of comparable quality and variety. This is not new. Historically, finance is widely used as an instrument of trade policy.

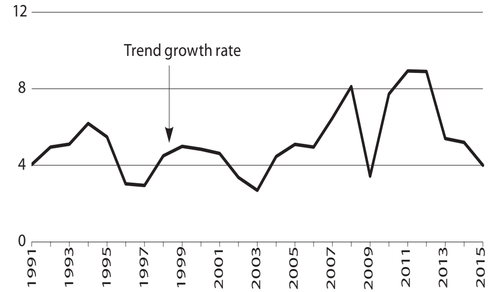
If the above speculation is correct, then there is a case for revisiting national development or investment banks for supply of long-term, low-cost credit for industrial capital formation. Such a case has acquired greater urgency in the context of the continuation of the global financial crisis, and the need for public investment to pull the depressed economies out of the present crisis (Skidelsky and Martin 2011; Turner 2015).

Another setback after the industrial reforms has been the decline in domestic industrial R&D. The licences to import technology and capital in the pre-reform era were conditional upon setting up domestic R&D centres (sweetened with fiscal concessions) to promote indigenous know how. After the reforms, firms no longer needed to make such efforts, and foreign firms had no reason to invest in R&D in India that could potentially compete with their parent firms' global interests. The net result: stagnation in R&D efforts, best illustrated again with a Chinese comparison. In 1996, both China and India spent the same share of their GDP on R&D, at 0.6%. However,

Company	Fund(s)	Valus (SM) Flipkart
Flipkart	Naspers, Tiger Global Mgmt, Accel Partners, Morgan Stanley Investment Mgmt, DST, Advisors, GIC, Sofina, Iconiq Capital	1,000
Flipkart	Qatar Investment Authority, DST advisor Greenoaks Ventures, GIC, Iconiq Capital, Tiger Global, Steadview Capital, T Rowe Price, Baillie Gifford & Co.	700
Snapdeal. com	Black Rock, Tybourne Capital Mgmt, Temasek, Soft. Bank, PI Opportunities Fund I, Myriad Asset Mgmt.	636
Unitech Corporate Parks	Brookfield	581
Kotak Mahindra Bank	Canada Pension Plan Investment Board (CPPIB)	376
Shriram Capitol	Piramal Enterprises	334
L&T IDPL	CDPQ, CPPIB, State General Reserve Fund (SGRF)	323
Jaiprakash Power ventures	IDFC Private Equity, PSP Investments	316
Sutherland	TPG Capital	300
Minces	CX Partners, Others	260
	Total	**4,826**

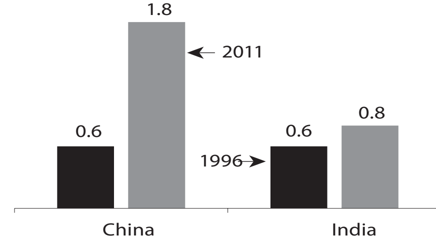
by 2011, the ratio for China had tripled to 1.8% of GDP, whereas for India the ratio had marginally moved up to 0.8% (Figure 14). Interestingly, despite its liberal FDI policy, China did not take its eyes off the strategic significance of R&D, whereas India perhaps lost its focus in the free market rhetoric (Mani

Figure 13: Installed Capacity, Annual Growth



Source: Economic Survey various issues.

Figure 14: R&D Expenditure as Percentage of GDP in China and India



Source: World Bank's World Development Indicators.

and Nabar 2016; Mani 2016).

At the height of the financial opening-up in the last decade, India signed a large number of bilateral free trade and investment agreements, whose outcome for industry appears to be questionable (Dhar et al 2012). In particular, the treaty with Thailand, a large base of the Japanese automotive industry, seems to have hurt Indian automotive firms', enabling the duty-free entry of goods. [12] If the observation is correct, then there is perhaps merit in reviewing such agreements. This is not to argue for unconditional protectionism or unalloyed faith in the state's capacity to promote industrialisation, but to seek for a more reasoned, rule-based support for industry. This should not be seen as a plea for putting the clock back; such a view would be ahistorical. What is needed, perhaps, is the redefining and reconfiguring of the boundaries of state

and market in view of the changed ground realities, comparative experiences, and the renewed analytical arguments for suitable state intervention.

Conclusions

Liberal economic reforms or the market-friendly policy frame-work constructed over the last quarter century has not served the manufacturing sector well, despite faster economic growth, and output diversification. The goal of rapid industrialising to catch up with Asian peers, in an open trade and capital regime employing abundant labour for labour-intensive exports, did not materialise. There has been undeniable improvement in domestic competition with the rise in the quality and variety of goods produced and exported. Yet, the share of manufacturing in GDP has stagnated, and its share in merchandise exports declined, and import content in domestic consumption shot up.

An eroding industrial base has found political expression in the current political dispensation's slogan, "Make in India," or in the previous regime's National Manufacturing Policy, 2011, albeit these ideas are yet to get translated into workable policies and suitable instruments for implementation. The easy starting point of it would be to try producing domestically what is being imported. The sharp rise in imports during the recent years clearly shows the potential to indigenise production quickly.

Ruling dispensations, regardless of their political colour and candour, have argued for "finishing" or "completing" the lib-eral economic reforms agenda, including institutional reforms, to reap their virtuous outcomes. However, after a quarter century of persuasion, such an advocacy rings hollow as it does not have support either in theory or in comparative experience. Worldwide rethinking on the virtues of unbridled globalisation of trade and investment after the global financial crisis is a testament to limits of such arguments, in the current stage of political democracy.

The policymakers' single-minded focus on improving India's ranking in the World Bank's Ease of Doing Business index (mainly by whittling down protective measures for the working poor) seems seriously misplaced as the index has no analytical basis or empirical support. Further, easing of entry of foreign capital even into defence production is completely mis-placed when most of the FDI inflow is from private equity firms, which specialise in flipping assets for quick returns, not digging their heels for long-term growth of shared gains.

Unalloyed faith in liberal reforms seems passé (Ostry et al 2016). As Dani Rodrik (2016) said recently,

The new model of globalisation stood priorities on their head, effectively putting democracy to work for the global economy, instead of the other way around. The elimination of barriers to trade and finance became an end in itself, rather than a means toward more fundamental economic and social goals. Societies were asked to subject domestic economies to the whims of global fi nancial markets; sign investment treaties that created special rights for foreign companies; and reduce corporate and

top income taxes to attract footloose corporations.

With global economic recession continuing after eight years of the financial crisis, and its political fallout in terms of Brexit, or ultra nationalism in the US, and the proposed scrapping of the Trans-Pacific Partnership by the US seem clear signals of the current limits to globalism. Considering the current global political and economic uncertainties, it would be prudent to pause and reflect on the liberal model. There is perhaps a need to revitalise the idea of the development state for retaking the initiatives for industrialisation.

Such a vision should not be misconstrued as a plea for a reversal to uncritical infant industry protection or complete de-linking from international trade and capital flows. Surely, with rising agriculture productivity and structural transformation, industrial growth will have to turn increasingly to exports for sustaining domestic growth. Yet, for a large economy like India—to paraphrase Arthur Lewis—exports will have to be the efficient lubricant for the large domestic economy, especially to meet energy import needs. It calls for strategic integration with the global economy and reinventing industrial policy keeping in view the long-term national goals.

The structuralist economic view of India's long-term constraints, as low agriculture productivity (compared to the global average), poor public infrastructure and extreme energy import dependence, seem to hold considerable value to this date. So, at a macroeconomic level, such a view would call for state intervention to step up domestic savings and public investment, and insulate the domestic economy from short-term volatility emanating from the global economy.

We probably need to identify industries and products in which imports are succeeding on account of easy credit, and those which require productivity improvement. There is apparently a need for reconfiguring a strategy for capital goods development (in items like information and communications technology hardware or in solar energy), in which India has become seriously importdependent, undermining the strategic national interests. This is not, however, a plea for blanket import substi-tution, and export pessimism, but for infusing technological dynamism to recapture the domestic market and the dynamic comparative advantage in trade. Capital and technology import should be accompanied with commitments for R&D investment.

There is a need to reimagine the role of domestic financial institutions to provide long-term credit for capital intensive industries, infrastructure and exports; along the lines advocated (separately) by Robert Skidelsky and Adair Turner in the current global context. These measures necessarily have fiscal counterparts, which need to be addressed by revisiting fiscal rules.

Similarly, domestic R&D, expenditure which has barely inched up during the reforms as a share of the GDP—compared to China, which tripled the ratio—needs to be seriously viewed and corrected if our present political dispensation is serious of realising its dream of techno-nationalism.

Notes

1 Unless otherwise mentioned, all figures are at constant prices.

2 This is different from the earlier experience of the 1980s when India's annual economic growth (as also that of China) accelerated to around 5.5%, while much of the global econo-my got mired in the debt crisis—known as the lost decade of development—after Mexico de-faulted on its international payments.

3 The index of industrial production (IIP) is a leading indicator of physical output with mini-mum lag, whereas the annual survey of indus-tries (ASI) is largely based on the annual cen-sus of production accounts of large factories, with data available with a two-year lag. Usual-ly, the ASI output growth estimates are higher than the IIP-based estimates. The gap between the two output series tends to diverge after about five years from the base year of the IIP.

4 For a detailed analytical account of this phase, see Nagaraj (2003).

5 Considering the uncertain data quality, we would restrict the analysis up to 2014.

6 For a detailed economic analysis of this period, see Nagaraj (2013).

7 For the details of the arguments reported in this section, see Nagaraj (2011) for a critical review of industrial performance until the boom of 2008.

8 The surge in initial public offerings (IPO) in 2016 seems to be a case in point. Indian compa-nies have mobilised close to $3 billion (`19,379 crore) during January–September 2016, the highest since 2007. Yet, it does not seem to be for augmenting fi xed capital formation, but for enabling PEs, which invested during the boom in the last decade to cash out their profits, or dilute promoters' equity holding to pay off PE investors, see Aarati Krishnan (2016).

9 As official data on FDI inflows are not available by type of institution, we have relied on non-official sources.

10 For a careful account of how the changes in the policy-affected industrial growth and capabili-ty, see Chaudhuri (2013, 2015).

11 China's entry into the World Trade Organiza-tion (WTO) seems instructive. It carefully ne-gotiated its terms of entry, timed the entry well to take advantage of the global market for its labour-intensive goods at an undervalued ex-change rate, and defended the rate for well over a decade to flood the world with its cheap manufacturing. In the process, China, strategi-cally, was able to convert its surplus labour into trade surplus, to gain immense advantage in global fi nancial markets.

12 "Industry has been ruined by FTAs," says Baba Kalyani, Chairman of Bharat Forge, and Kalya-ni group of companies with a turnover of $2.5 billion, specialising in automotive forging, sup-plying to major OE manufacturers worldwide. He said in an interview, "Industry has been ruined by FTAs … because of the FTA, due to which companies come and set up plants here they don't manufacture anything, they just assemble" (Bhagat 2014).

Acknowledgement

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REAL ESTATE : The Impact of RERA 2016 & Demonetization

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*Akshay Deepak**

Summary

Real Estate is one of the largest contributors to the GDP of Indiaand in a country where majority of population in major cities lives on rent and dreams of owning a home, real estate has gradually matured into a huge business sector in its own. However, this is one such industry which is also equally notorious for presence of institutional voids and absence of transparency. Even amidst all the challenges though, the real estate sector has shown positive growth over the years but also it has also suffered badly from the erosion of faith of customers. This paper describes the various aspects & challenges associated with Indian Real Estate Market, along with the critical analysis of the newly implemented Real Estate Regulatory Authority Bill by the government of India.

Introduction

Indian Real Estate Market is well set to cross the USD 853 Billion mark by 2028.

Indian real estate market can broadly be divided into following segments:

1. Residential
2. Commercial
3. Retail
4. Hospitality
5. Special Economic Zones(SEZs)

Of these, Residential Space alone contributes to around 80% of the entire real estate sector and has a very large number of players. On the other hand, Commercial & Retail Spaces are the ones that are gaining significance gradually and witnessing emergence of big players in the segment. It is primarily the metro cities which is the growth driver for this segment. The hospitality segment has been slow in growth whereas incoming of huge investment in IT &ITeS as well as in other sectors is bound to give good boost to the SEZs. Of 416 SEZs formally approved by the government, 199 have already come up while work on most of the others has started or expected to start in the times to come.

Having said that, the complexities and challenges associated with this sector in a developing market like that of India are far more and varied in nature as compared to those in developed markets like that of US, UK& Singapore. There are many reasons for it. For instance, some of the significant reasons are: the lack of knowledge about the legal intricacies associated with purchases, buyer builder agreements, legal compliances, lack of any standardized criteria for rating builders

[1] Real Estate Report by Indian Brand Equity Foundation December 2016

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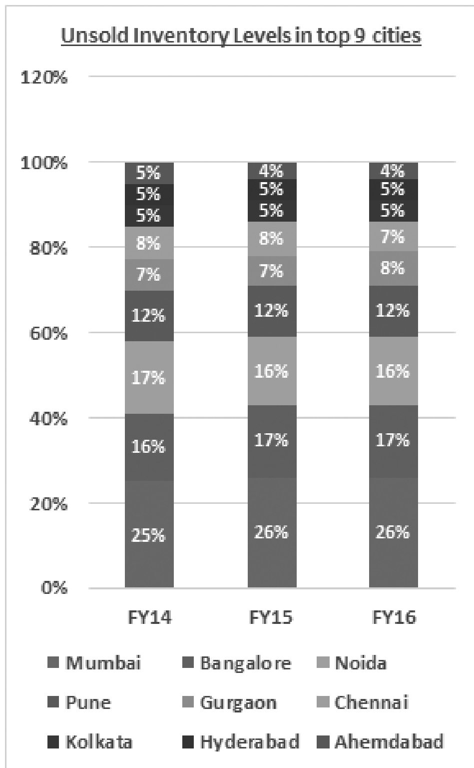
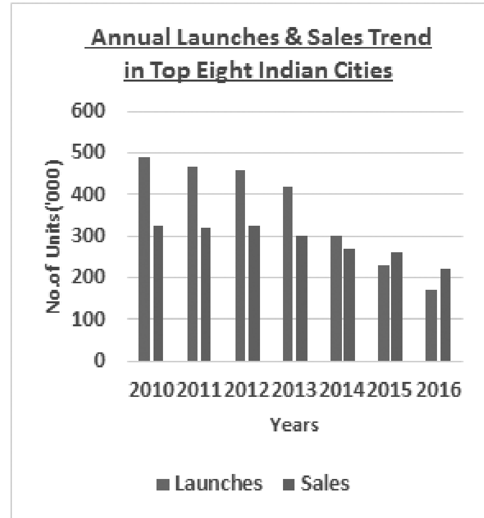
& projects, absence of any criteria for justifying the prices of projects, huge imbalance between demand & supply at most of the places and so on. This has led to real estate sector suffering greatly from erosion of faith of customers from the dealings & processes of home buying. As a consequence, over the past few years there has been a rise in the number of unsold inventories in the market. In 2016, Mumbai, Noida & Bangalore held maximum share of unsold inventories across the top 9 cities and not only this, these cities had the inventory overhang of about 40 months which is a significant number.

Following graph shows the status of unsold inventories in top 9 cities:



Source: (Prop Tiger, 2016)

Contemporary Market Outlook



Source: (Knight & Frank, 2016)

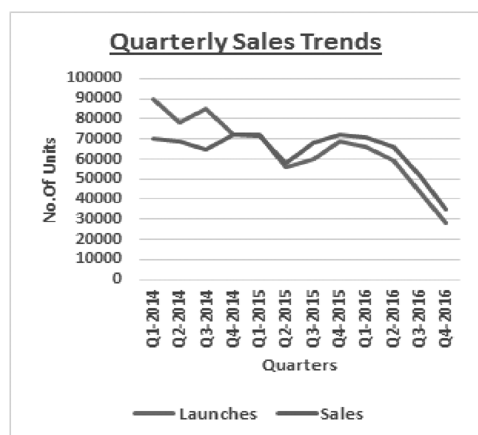
Years 2010-12 are still considered to be the golden years for real estate when the new launches as well as the sales graphs continuously showed upwardtrend and people were keen to invest in properties. The fact can be very well observed in the graph provided below which shows the trends for new launches & sales over these years & beyond.

However, post 2012, the market started cracking and suffered from erosion of faith of buyers due to a plethora of reasons. The sales started plummeting and stock of unsold inventories started mounting up. The next couple of years proved really hard for the sector and the players. The year 2016 started on a promising note, particularly in the slow growing residential segment. The first half of the year was relatively better as compared to the past couple of years with all major markets such as Mumbai, Bengaluru, Delhi-NCR hinting at signs of growth. In the first half of 2016, more than 1,35,000 units were sold as compared to 1,26,600

[2] India Real Estate Report by Knight & Frank

units in the first half of 2015 and almost same pace was maintained even during the beginning of the second half of the year with third quarter starting on a good note owing to arrival of festive season. With stable political environment, positive investment outlook, advent of Real Estate Regulatory Authority Act, GST etc. it was well expected that the sector will do well in the year 2016 after facing slow growth for past two years and which it did to some extent until the demonetization exercise happened in November, which had a significant impact on the pace at which the sector was expected to grow.

Post demonetization, the drop in sales in the fourth quarter was estimated to be around 44% YoY and the drop in new launches was estimated to be around 61% YoY during the period.It is estimated that around 40000 units were sold during this period which happens to be the lowest number of units sold in this quarter since 2010 . This one quarter alone nullified the rate growth which was witnessed in the early half of the year 2016 and consequently 2016 emerged as the worst year in the recent times as far as sales volume is concerned.



Source: (Knight & Frank, 2016)

Now in the light of the above mentioned facts & figures, it becomes extremely relevant to understand the impact of two major happenings in the real estate sector. One is the introduction of RERA Act & second is the impact of demonetization drive.

Let us try to understand the intricacies of each of these factors.

The Real Estate (Regulation & Development) Act 2016

The RERA bill was passed by the RajyaSabha on 10 March 2016 and by the LokSabha on 15 March 2016. It was enforced from 1 May 2016 with 69 of 92 sections notified. Within a statutory period of six months of enforcement of RERA, the State Governments are to frame to carry out the provisions of the Act. The Central Government released The Real Estate (Regulation & Development) General rules in October 2016. These rules are applicable to the five Union Territories (Andaman & Nicobar Islands, Chandigarh, Dadra & Nagar Haveli, Daman & Diu, Lakshadweep).

While Uttar Pradesh has been one of the leading states to publish its rules ahead of other states, the states of Maharashtra, Tamil Nadu, Karnataka are still in final stages of framing the rules.

The act mandates that the concerned government shall establish the real estate regulatory authority within one year from the date of enforcement of the Act, consisting of one chairperson and at least two full time members. The Chairperson & other members will be appointed by the

[3] India Real Estate Report by Knight & Frank

concerned government in consultation with the selection committee comprising of Chief Justice of High Court or his nominee from the concerned sector. If deemed fit, it is possible that two or more states or union territories can establish a single authority.

The prime functionalities of the authority shall include:Registering & regulating the various real estate projects as well as agents, to maintain & make available each & every relevant record to public through the official website, to ensure strict implementation of the rules & regulations laid down by the Act etc.

The prime objectives of the authority shall be to: Protect the interests of buyers, promoters & agents, ensure time bound approvals & clearances for projects to complete on time, put in place a strong & effective grievance redressal mechanism, to promote investment in the sector & devise provisions for providing financial assistance, to establish an effective dispute redressal mechanism, to facilitate digitization of land & property documents as well as transactions etc.

Besides, the act also mandates that the concerned government shall establish the real estate appellate tribunal within one year from the date of enforcement of the Act. Each bench of the tribunal shall consist of at least one judicial member & one administrative to technical member.

A person not satisfied with the decision or direction of the authority or adjudicating officer will have the right to appeal before the appellate tribunal having jurisdiction over the matter. An appeal shall preferably have to be made within 60 days of the decision/direction issued by the authority or the adjudicating officer.

The Act directs that no promoter in any way can advertise, promote, sell, accept money for any project that has not been registered with the regulatory authority established by the act. In order to apply for registration, a promoter shall have to disclose authentic information on a number of aspects, some of them being: Name of Enterprise, its company structure, its type, particulars of various other registrations, details of the promoter(s) etc., brief details of the projects constructed over a period of past five years along with proper records of land payments and legal cases pending if any as well as the status report on the on-going projects, etc. In addition, it puts forth the concept of mandatory escrow account wherein 70% of the amount realized for the project shall have to be deposited in a separate dedicated account and are to be strictly employed in the development of that particular project only. The amounts can be withdrawn only after the quantity being approved by an associated certified engineer or an architect or a chartered accountant confirming its use and specifying the proportion of project for the amount shall be utilized. These accounts shall be audited within six months after the completion of a financial year by a chartered accountant in practice.

Provision for Penalties

In case the promoter is found guilty of violating any of the regulations as specified by the Act, he is liable to pay a penalty of up to 10% of the total cost of the project. In case he continues defying the directions or decisions of

the authority he is liable to receive imprisonment of up to 3 years along with further 10% penalty.

If a promoter is found furnishing misleading information he is liable to pay a penalty of up to 5% of the total cost of the project.

Not just the promoter, even if the real estate agent is found guilty of violating the provisions, he is liable to pay a penalty of Rs 10,000 per day. The same holds true if an allottee fails to abide by the terms & conditions agreed upon by him or violates any regulation of the act.

Impact Of Real Estate (Regulation & Development) Act 2016

Let us now try to understand the impact of RERA on various stakeholders.

Impact on Developers

RERA will certainly to some extent put a check on the malpractices going on in the selling process. Developers will not be able to charge prices on the basis of super area and hence the developers offering lower loading in projects will benefit. It will be tough for developers to modify the super area, layout of project & specifications etc. because any such change will now require consent of at least two third of the buyers. The concept of escrow account will make it tough for developers to divert money into different projects at the same time and hence the overall cost of capital shall rise.

Impact on Pricing

As RERA directs the sale of apartments on basis of carpet area, builders will have to relook at the pricing strategy to mitigate the losses which they might suffer. It is so because concept of super area & loading gave them a big margin for making money. There are circumstances possible in which the stamp duty rates & premium FSI rates may need to be reframed or revised. In all possibility the overall cost of capital is going to escalate for the builders. It is because of the simple reason that after enactment of RERA, the builders will have to first obtain all the approvals before the sales can start. Hence the money which they used to pick up from soft launch stages and invest in paying installments for land will now be wiped away in majority of the cases and consequently paying interest rates etc. on land will be much tougher now.Developers will now have to rely more on equity aspects of raising money rather than debt financing.

Impact on Buyers

RERA has been observed as a big relief by the buyers.As real estate sector is anyhow full of information asymmetries, so while earlier they have to rely on agent or builder for information, the buyers will now have more authentic information about the developer & the project by means of RERA.With the Act mandating the developers to furnish all the relevant information (such as the past record of projects, clarity on approvals & NOCs, clarity on number of phases in the project etc.) on the website & brochure, buyers will now be better educatedand informed in dealing with the transactions& have a proper channel for addressing their grievances

Possible Chinks in the Armor of RERA

No doubt RERA is a very strong & positive step towards making the sector more organized & clean, yet it does have its own share of ambiguities.

Firstly, RERA norms & guidelines shall be applicable to the projects which are being launched after the implementation of the Act. For projects which have already been going on when the act is enforced but are yet to receive certificate of completion shall have to apply for the registration with the authority within a stipulated period of three months from the enforcement of the act.However there still exist doubt & questions over how will RERA serve the customers who have already bought property but are suffering due to one reason or the other. This segment constitutes a significantly large customer base so how does it tackle with projects which are already delayed or where customers have been exploited.

Secondly,if we look carefully, the definition of a real estate agent as per the Act also includes those who just introduce buyers and sellers irrespective of the fact whether they are involved in transaction or not. Now if this be true, how are aggregator portals like magicbricks.com, 99acres.com etc. are to be treated? Do they also come under the purview of the Act and if yes, then to what extent?

Third, the Act by means of escrow account though tries to ensure that the developer doesn't divert money to other projects, but at the same time it will also raise the overall cost of capital and this burden in all possibility shall be passed on to the buyers.

Fourth, it says that the developer shall be able to withdraw money from the account only after it has been approved by an associated certified engineer or an architect or a chartered accountant confirming its use and specifying the proportion of project for the amount shall be utilized. Now it is also unclear how does it prevent developer from withdrawing money at his own will as the concept of utilization in itself is very subjective and contextual.

Besides, the Act comes under the purview of concurrent list and hence both the state & the union have legislation over it & conflicts can always ruin the very purpose of the Act. Hence the concerned existing state laws need to be in sync as well with RERA & vice versa. This is one of the prime reasons behind why there are many states which have not yet been able to frame rules for carrying out the provisions of the Act.

However, having said that, the Act has been a remarkable step taken by the government in the direction of bringing transparency in the sector and to safeguard the interests of the buyers but a lot still depends upon how diligently the Act is implemented and followed.

Impact of demonetization

We have seen earlier how the act of demonetization nullified the growth & pace which the market had gained in the early half of the 2016. Following are some of the estimates of revenue loss that happened due to demonetization. During this one quarter it is estimated that the industry suffered a loss in revenues of up to USD 226 billion whereas the loss for state governments on stamp duties collection has been to the tune of USD 12 billion.

It is worth noting that the market which has been hit worse is the secondary market, particularly in Tier-II & Tier-III cities where cash component &

unaccounted money in transactions have been more or less a very common practice.The resale property market has taken a hard blow because of the nature of cash dealings and unaccounted transactions.

As far as primary market (very specifically related to builders with high credibility) in major cities is concerned, the impact has not been that high as most of the transactions involved organized finance & loan procedures to a great extent. It has suffered more because of the mindset of wait & watch which the buyers adopted after demonetization as there was an air of uncertainty and people wanted to hold their investment plans. However undoubtedly, there is no denying that the sector suffered a blow due to demonetization.

Conclusion

It is worth analyzing that demonetization, has led to bringing in the cash into the system which was existing in some kind of parallel economy and going unaccounted. This cash which will now reflect in individual's account will lead to raise his eligibility for obtaining more loans and curb the transactions which could have otherwise taken place unaccounted. Adding to that, post demonetization, the banks have been swelling up with high liquidity which translates into banks having more money to lend, ultimately giving rise to a very strong and logical speculation that we may see a fall in interest rates which will further fuel the demand of homes in the real estate sector.In such scenario, the hard blow suffered by the resale market due to demonetization can actually provide a positive push to the sales in primary market.

Not only this, the advent of the Act has already made the developers very vigilant & cautious about the processes involved in the entire sales cycle particularly in the transaction stages. So in the coming times the full-fledged implementation of the Act along with advent of GST, measures to check on Benaami property (as described by the Prime Minister), possible lowering of interest rates, attractive incentives under Pradhan MantriAwasYojna(PMAY) are expected to create a positive & feel good environment which is essential for the industry to grow & flourish. Consequently, better times are being anticipated by the buyers as well as developers in 2017.

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The Real Estate (Regulation AND Development) Bill, 2016.

Budgeting for Inclusive Growth in the Current Macroeconomic Context

Ashima Goyal*

Inclusive growth

The literature distinguishes between narrow and broad inclusion. While the first just reduces inequality the second gives broad rights, voice and capabilities to make the excluded active participants. Active inclusion empowers by increasing rewards to work thus creating conditions for the many to contribute to and participate in growth. It suits India's youthful demographics, growth potential, and emphasis on entrepreneurship, while redistributive strategies may continue to be necessary for persistent poverty.

One attribute of poverty is being trapped in poor quality of consumption, and in goods where there is not much innovation that can create different types of potential. Normally innovation takes place in high end technologies, but we are seeing innovation in technologies that the poor can also use (Goyal, 2016)—such as the mobile, payments and financial inclusion.

Research also finds pure income transfers need not shift the poor to dynamic technologies that show continuous improvement. But improving infrastructure and reducing their transaction costs does, since it reduces the relative prices of medium-level technologies for the poor and makes them more accessible. Such technologies tend to have a higher relative price for the poor. If the poor can start using them their opportunities expand. Moreover, a larger market size induces innovation in accessible technologies, which creates jobs and growth.

High end technologies have a higher price so that more innovation takes place in such technologies. A larger market size can induce inclusive innovations in accessible technologies despite their lower price if the skills necessary to develop and use them are more evenly endowed.

For active inclusion, therefore, the budget should work towards raising the returns to work and improving consumer choices. Then productivity, investment and innovation could rise in a virtuous cycle. It should improve human capital as well infrastructure, and reduce transaction costs. Since they are also State subjects, States could be incentivised to spend more on health and education, even as their share in the central budget goes up. The Brazilian bolsa familia, one of the most successful welfare programs, used conditional transfers very effectively to improve human capital. This is the route aadhar based DBTs should take, rather than a generalized pure transfer such as a basic income scheme. It would also be more economical given our current low tax/GDP ratios.

Gender

Similar issues rise with respect to gender. To truly empower women, conditions for their participation in work and in society should be improved. Many of their contributions to society are not recognized. Reducing household income tax by the unpaid female care work for upto 2 children and aged parents would help to change this. If the money is transferred to the woman her bargaining power, as well as

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the quality of a household's spending, would improve. Research shows that in poor households where men would spend on drink, women spend on goods that improve the household's prospects.

Spending on higher quality goods stimulates investment and innovation. India's growth revival after the global financial crisis proved short-lived because it was dominated by consumption oriented towards food where supply bottlenecks existed, so the only result was high inflation. This year the pay commission awards should stimulate a more productive consumption that can reduce excess capacity in industry.

Macroeconomic context

Tax rationalisation: But demonetisation has sharply reduced consumption. Tax cuts and simplification in the tax structure could help revive this with a rebalancing away from luxury goods towards middle class consumer goods, without disturbing fiscal consolidation. Such consumer goods would have more thick linkages improving innovation and productivity through the system. It would also contribute to shifting society to a norm of universal payment of a low tax, thus adding carrots to the sticks used against tax evaders. As more information and other action on black incomes increases the income tax base, use of digital money increases service tax compliance, cross border tax information sharing and reworking of tax avoidance treaties, as with Mauritius and Singapore, increases compliance by cross border capital all improve tax compliance making it more feasible. India's increasing reliance on indirect taxes, which both rich and poor have to pay, is regressive. Reductions in lower income tax slab rates and higher exemption limits would improve balance.

Other measures to maintain the momentum against black money and plug loopholes include reducing high stamp duties, and taxing agricultural incomes above a threshold. Incentives for adoption of digital payment modes would help shrink the informal sector, creating a rich data base.

Encouraging investment: The government has been trying for long to spend more on capital formation, without much effect on the aggregate numbers, so private investment must be facilitated. A major way to do this is to prepare a package for the banks and industries where asset quality has been allowed to deteriorate and fester. Since the banks are PSBs where the government is the majority shareholder, and the industries are largely in infrastructure, a package could be designed where asset sales are combined with fund infusion to clean balance sheets, thus equitably sharing pain, reviving investment and growth. After the financial crisis the US effectively turned around its car industry and banks with such strategies. Small enterprises are the main creators of employment and have been suffering from the drying up of bank credit to industry, since it is difficult for them to access market instruments.

Global trends: There are positives and negatives in global trends. But given uncertainty surrounding international trade, and a possible rise in US interest rates, which may restrain domestic monetary stimuli, the budget must take the initiative to sustain domestic demand and growth.

Acknowledgement

The article is based on my comments at the 12th January EPW-Bombay Chamber of Commerce and Industry event on the Budget. I thank the organizers for the invitation.

Reference

Goyal, Ashima. 'Conditions for Inclusive Innovation with Application to Telecom and Mobile Banking', Innovation and Development. 2016. DOI:10.1080/2157930X.2016.1187845.

The Case for an Expansionary Fiscal Policy

*Surajit Mazumdar**

Summary

That demonetization has had a contractionary effect on the Indian economy is a foregone conclusion given the importance of cash transactions in it. Any shade of economic theory would predict this as the short-run or immediate effect of the withdrawal of legal tender status of notes making up 86 per cent of the currency in circulation.

Introduction

The Though the RBI has refused to release, so far, any data on the value of Specified Bank Notes (SBNs) returned to it or the precise amount of fresh currency issued by it, from the available figures of the currency in circulation issued weekly by the RBI (which still includes any SBNs not deposited by the public in banks) it is clear that we are still quite far away from restoring the pre-demonetization levels.

While one of the arguments made in favour of the demonetization decision has been that it will yield long-term benefits, the focus here is on a long-run that began on 8 November 2016. With reference to the Indian economy, however, it may make more sense to see the demonetization episode as an additional factor reinforcing a sluggish tendency that set in long before demonetization and has been present for some years at least.

If one were to move away from the GDP growth figures put out by the CSO in the National Accounts Statistics (NAS) and look at indicators of physical production trends– like the indices of agricultural and industrial production - the story that emerges is of virtual stagnation in output since 2011-12. Further, while there is a very sharp and perhaps mysterious difference in the manufacturing growth trends emerging from the NAS and the IIP, the NAS also throws up trends indicative of sluggishness in the economy. The NAS, for instance, does show that construction activities, whose rapid expansion from the mid-1990s had been one of the singular features of Indian growth for one and a half decades, have experienced a very sharp slowdown over the last few years. Moreover, manufacturing investment has been stagnant for nearly a decade, having never recovered from the disruption of the boom that preceded the eruption of the global crisis. This has also dragged down India's overall investment growth and the investment-ratio has thus been in continuous decline, in sharp contrast to the high-growth phase in the early years of the century before the crisis. Indeed, if one looks at the expenditure on GDP, almost all components – investment, government consumption expenditure and trade in goods and services - have been growing slower than overall GDP and only private consumption seems to be somewhat keeping pace. However, consumption growth cannot sustain by itself. Moreover, while the adverse

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trends in exports reflect the global economic situation the same trends in imports indicate not the replacement of imports by domestic production but the slow growth of the sectors which generate demand for imports.

In short, there have been for the last 5-6 years several indicators of the Indian economy facing severe and persistent demand constraints and the 'improvements' in the current account and inflation situations should be seen as reflections of this and the fall in global oil prices. What has been an additional feature of this period has been the sharp slowdown in real public expenditure growth compared to the second half of the 2000s. First the high revenue growth during the boom years before the 2008 crisis and then the subsequent fiscal stimulus had combined to ensure relatively faster expansion of public expenditure for a few years starting from around 2005. The post-crisis phase of this was also, however, accompanied by a sharp reduction in the tax-GDP ratio and a consequent rise in the fiscal deficit. This prompted the turn towards fiscal 'consolidation' from 2011-12 pursued by both the UPA as well as the NDA governments. This did not, however, mean a recovery of the tax-GDP ratio to 2007-08 levels. The composition of tax-revenue has also moved in an adverse direction as the share of direct taxes has declined – particularly the corporate-tax to GDP ratio has been consistently declining. The last two years have also seen the same thing with revenues being held up mainly by garnering additional excise duties enabled by the decline in international oil prices. The burden of reducing the fiscal deficit has thus largely fallen on public expenditure – the holding back of which has reinforced rather than corrected the demand constraints. Indeed, what one has seen often is revenues falling short of targets and expenditures being also correspondingly curtailed to ensure fiscal deficit targets are met.

Seen in the light of the above, there is a case for a shift to a more expansionary fiscal policy involving expenditure growth rather than tax concessions. However, this should not be seen as merely a short-term measure to address an immediate aggregate demand problem. The fundamental problems of the Indian economy, including the source of its demand constraints, are structural. The are several interrelated imbalances that characterize the Indian economy - between different sectors, in the trade with the rest of the world and very importantly in the distribution of income and spending ability. Contractionary fiscal policy in such circumstances also creates an additional reinforcing imbalance between public and private expenditure. Fiscal policy in a more expansionary mode, on the other hand, can contribute to creating the space for using taxation and expenditure policies to address the fundamental structural balances of the Indian economy and to put it on a more sustainable growth path.

Acknowledgement

This is based on my presentation at the Bombay Chamber of Commerce-EPW panel discussion on 'How Will Budget 2017 Impact the Economy in The Aftermath of Demonetization' held on 12th January 2017. Now that the Union Budget has been presented in Parliament, one can say that it is clearly not in line with what has been suggested in this write-up or the presentation on which it is based.

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