

Dear Members,
Greetings!

Economic Survey 2018-19

Political stability to push animal spirits: Strong economic recovery seen in 2019-20

Over the last five years, India's economy has performed well. By opening up several pathways for growth, the government has ensured that the benefits of growth and macroeconomic stability reach the bottom of the pyramid.

To achieve the objective of becoming a US\$5 trillion economy by 2024-25, India needs to sustain a growth rate of 8%. International experience, especially from high-growth East Asian economies, suggests that such growth can only be sustained by a "virtuous cycle" of savings, investment and exports, supported by a favourable demographic phase. Investment, especially private investment, is the "key driver" that drives demand, creates capacity, increases labour productivity, introduces technology, allows creative destruction and generates jobs.

Exports must form an integral part of the growth model because higher savings preclude domestic consumption as the driver of final demand. Similarly, job creation is driven by this virtuous cycle. A common claim is often made that investment displaces jobs, this remains true only when viewed within the context of a specific activity. When examined across the entire value chain, capital investment fosters job creation as production of capital goods, research & development and supply chains generate jobs.

Extending the above growth model, the Survey departs from traditional Anglo-Saxon thinking regarding the economy as being either in a virtuous or a vicious cycle, and thus never in equilibrium.

Presenting data as a public good, emphasizing legal reform, ensuring policy consistency, encouraging behaviour change using principles of behavioural economics, the Survey aims to enable and sustain the virtuous cycle. Key ingredients include a focus on policies that nourish MSMEs to create jobs and become more productive, reduce the cost of capital, and rationalise the risk-return trade-off for investments.

State of the Economy: A Macro View

The Government has projected the real GDP growth for the year 2019-20 at 7 per cent, on the back of anticipated pickup in the growth of investment and acceleration in the growth of consumption. India's growth of real GDP has been high with average growth of 7.5 per cent in the last 5 years (2014-15 onwards). The Indian economy grew at 6.8 per cent in 2018-19, thereby experiencing some moderation in growth when compared to the previous year.

India continues to remain the fastest growing major economy in the world in 2018-19, despite a slight moderation in its GDP growth from 7.2 per cent in 2017-18 to 6.8 per cent in 2018-19.



On the external front, current account deficit (CAD) increased from 1.9 per cent of GDP in 2017-18 to 2.6 per cent in April-December 2018. The widening of the CAD was largely on account of a higher trade deficit driven by rise in international crude oil prices (Indian basket). The trade deficit increased from US\$ 162.1 billion in 2017-18 to US\$ 184 billion 2018-19. Merchandise imports reduced from 21.1 per cent to 10.4 per cent. Growth in service exports and imports in US dollar terms declined to 5.5 per cent and 6.7 per cent respectively in 2018-19, from 18.8 per cent and 22.6 per cent respectively in 2017-18.

Rupee depreciated by 7.8 per cent vis-à-vis US dollar, 7.7 per cent against Yen, and 6.8 per cent against

Euro and Pound Sterling in 2018-19. During 2018-19, Indian rupee traded with a depreciating trend against US dollar and touched Rs. 74.4 per US dollar in October 2018 before recovering to Rs. 69.2 per US dollar at end March 2019.

The foreign exchange reserves in nominal terms (including the valuation effects) decreased by US\$ 11.6 billion end-March 2019 over end-March 2018. Within the year, foreign exchange reserves were declining until October 2018 due to RBI's intervention to modulate exchange rate volatility. India's foreign exchange reserves continue to be comfortably placed at US \$ 422.2 billion, as on 14th June 2019.

Net Foreign Direct Investment (FDI) inflows grew by 14.2 per cent in 2018-19. Indian banking sector has been dealing with twin balance sheet problem, which refers to stressed, corporate and bank balance sheets. Consumption has always been a strong and major driver of growth in the economy. Decline in investment rate and fixed investment rate since 2011-12, seems to have bottomed out with some early signs of recovery since 2017-18. Fixed investment growth picked up from 8.3 per cent in 2016-17 to 9.3 per cent in 2017-18 and further to 10.0 per cent in 2018-19.

In 2017-18, investment rate in services sector became the highest. Investment rate in agriculture still continues to lag behind and now is half the investment rate in the industry sector. Simultaneously, there has been a decline in savings rate as well, with the household sector entirely contributing to the decline. Household savings declined from 23.6 % in 2011-12 to 17.2 % in 2017-18.

The trend of growth of exports and imports was different in 2018-19 in rupee and US dollar terms. While growth of both export and import declined in US\$ terms, it increased in rupee terms (at current prices) in 2018-19. This happened due to the depreciation of rupee vis-a vis US dollar in 2018-19.

Gross Value Added reflected a decline in economic activity, registering a growth of 6.6 per cent in 2018-19, lower than 6.9 per cent in 2017-18. Growth of net indirect taxes was 8.8 per cent in 2018-19, lower than that of 2017-18 on account of loss of momentum of economic activity.

Service sector is the most dynamic sector in the economy and has remained the key driver of economic growth along with being a major contributor to GVA and export basket of the Indian Economy.

Real growth in 'Agriculture & allied' sector was lower in 2018-19 at 2.9 per cent, after two years of good agriculture growth. As per the 3rd Advance Estimates released by Ministry of Agriculture & Farmers Welfare, the total production of foodgrains during 2018-19 is estimated at 283.4 million tones in 2017-18. Growth in the industry accelerated during 2018-19 on the strength of improving manufacturing and construction activity, which have more than offset the declaration in the other two sub sectors, 'Mining & quarrying' and 'Electricity, gas, water supply & other utility services'. Manufacturing accounted for 16.4 per cent in total GVA in 2018-19, marginally higher than that of 'Agriculture & allied' sector .

The growth in manufacturing sector picked up in 2018-19, although the momentum slowed down towards the end of the financial year with a growth of 3.1 per cent in fourth quarter of the year, as compared to 12.1 per cent, 6.9 per cent and 6.4 per cent in first, second and third quarter respectively. The growth rate in Q4 of 2018-19 moderated considerably, on account of lower NBFC lending, which in

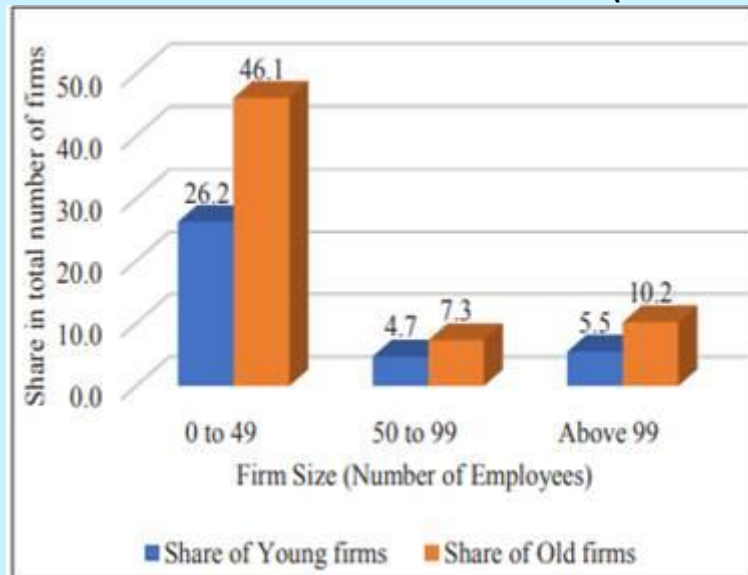
part led to sales in the auto sector.

Key Highlights of the Economic Survey

- **Nourishing Dwarfs to become Giants: Reorienting policies for MSME Growth**

MSMEs that grow not only create greater profits for their promoters but also contribute to job creation and productivity in the economy. Therefore policies focus on enabling MSMEs to grow by unshackling them. Incentivizing 'infant' firms rather than 'small firms: With the appropriate grandfathering of existing incentives, they need to be shifted away from dwarfs to infants. When such incentives are provided to firms irrespective of their age, the incentives create "perverse" incentives for firms to stay small. Such perverse incentives would not be there if age is the criterion. Misuse of the age based criterion can be easily avoided using Aadhaar. Re-orienting Priority Sector Lending (PSL): As per extant policy, certain targets have been prescribed for banks for lending to the Micro, Small and Medium (MSME) sector that exacerbates perverse incentives to firms to remain small. Under MSME's PSL targets, it is necessary to prioritize 'start ups' and 'infants' in high employment elastic sectors.

Share of dwarfs versus others in number of firms (as of 2016-17)



Source: PHD Research Bureau compiled from Economic Survey 2018-19

Sunset Clause for Incentives: With appropriate grandfathering, every incentive for fostering growth should have a 'sunset' clause, say, for a period of five to seven years after which the firm should be able to sustain itself. **Focus on Service Sectors with high Spillover Effects such as Tourism:** Developing key tourist centres will have ripple effects on job creation in areas such as tour and safari guides, hotels, catering and housekeeping staff, shops at tourist spots etc.

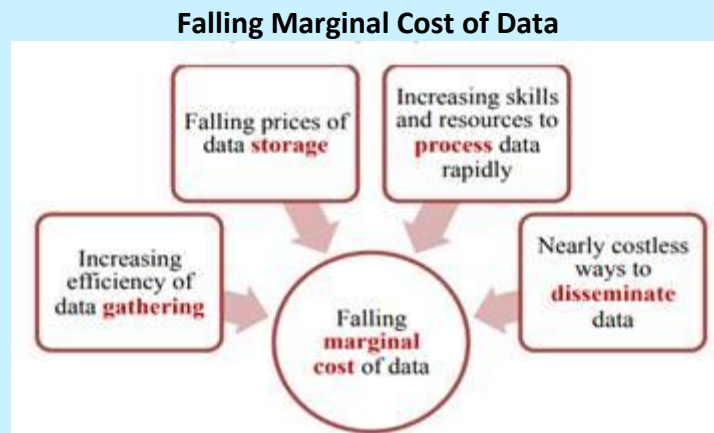
- **Policy for Homo Sapiens, Not Homo Economicus**

Decisions made by real people often deviate from the impractical robots theorized in classical economics

Drawing on the psychology of human behaviour, behavioural economics provides insights to ‘nudge’ people towards desirable behaviour. The key principles of behavioural economics are ‘emphasising the beneficial social norm’, ‘changing the default option’ and ‘repeated reinforcements’. Swachh Bharat Mission (SBM) and the Beti Bachao Beti Padhao (BBBP) have successfully employed behavioural insights. Insights from behavioural economics can be strategically utilised to create an aspirational agenda for social change: (i) from BBBP to BADLAV (Beti Aapki Dhan Lakshmi Aur Vijay Lakshmi); (ii) from Swachh Bharat to Sundar Bharat; (iii) from “Give It Up” for the LPG subsidy to “Think about the Subsidy”; and (iv) from tax evasion to tax compliance.

- **Data “Of the People, By the People, For the People”**

Given technological advances in gathering and storage of data, society’s optimal consumption of data is higher than ever. As private sector may not invest in harnessing data where it is profitable, government must intervene in creating data as a public good, especially of the poor and in social sectors of the country. Governments already hold a rich repository of administrative, survey, institutional and transactions data about citizens, but these data are scattered across numerous government bodies. Merging these distinct datasets would generate multiple benefits with the applications being limitless. Given that sophisticated technologies already exist to protect and share confidential information, data can be created as a public good within the legal framework of data privacy.



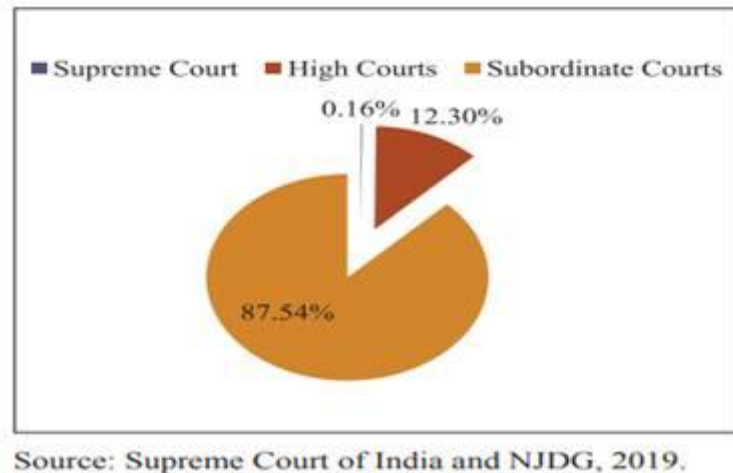
Source: PHD Research Bureau compiled from Economic Survey 2018-19

In thinking about data as a public good, care must also be taken to not impose the elite’s preference of privacy on the poor, who care for a better quality of living the most. As data of societal interest is generated by the people, it should be “of the people, by the people, for the people.”

- **Ramp Up Capacity In The Lower Judiciary**

Delays in contract enforcement and disposal resolution are arguably now the single biggest hurdle to the ease of doing business in India and higher GDP growth. Around 87.5 per cent of pending cases are in the District and Subordinate courts. Therefore, this segment must be the focus of reform.

Distribution of Pending Cases among different levels of Courts in India



The study found that 100 per cent clearance rate can be achieved by merely filling out the vacancies in the lower courts and in the High Courts (even without the productivity gains). Simulations of efficiency gains and additional judges needed to clear the backlog in five years suggest that the numbers are large but achievable. The states of Uttar Pradesh, Bihar, Odisha and West Bengal need special attention.

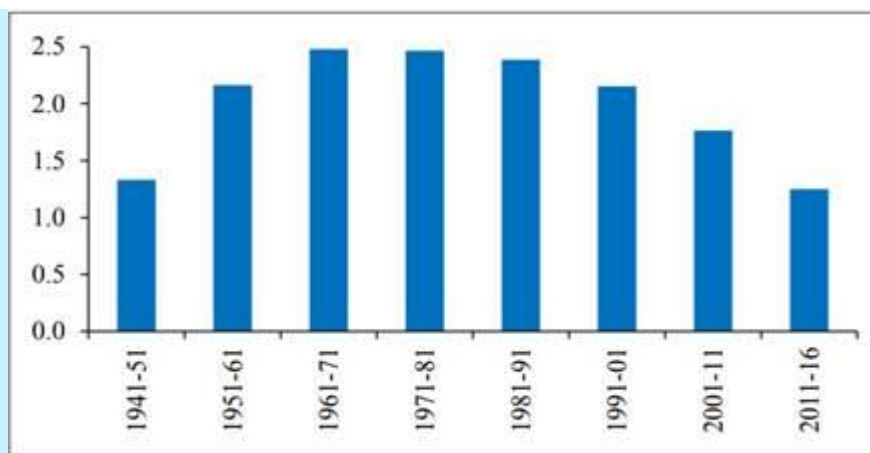
- **Policy uncertainty affecting investments**

Economic Policy Uncertainty has reduced significantly in India over the last decade. Continued decline in economic policy uncertainty in India post 2015 is exceptional because it contrasts sharply with the increase during this period in economic policy uncertainty in major countries, especially the U.S. An increase in economic policy uncertainty dampens investment growth in India for about five quarters. Unlike generic economic uncertainty, which cannot be controlled, policymakers can reduce economic policy uncertainty to foster a salutary investment climate in the country. Forward guidance, consistency of actual policy with forward guidance, and quality assurance certification of processes in Government departments can help to reduce economic policy uncertainty. .

- **India's Demography at 2040: Planning Public Good Provision for the 21st Century**

- India is set to witness a sharp slowdown in population growth in the next two decades. Although the country as a whole will enjoy the “demographic dividend” phase, some states will start transitioning to an ageing society by the 2030s.

Annual Population Growth Rate in India (per cent)



Source: Census 2011, International Institute for Population Sciences (IIPS) estimates.

A surprising fact is that population in the 0-19 age bracket has already peaked due to sharp declines in total fertility rates (TFR) across the country. The national TFR is expected to be below replacement rate by 2021. Working-age population will grow by roughly 9.7mn per year during 2021-31 and 4.2mn per year in 2031-41. The proportion of elementary school-going children, i.e. 5-14 age group, will witness significant declines. Contrary to popular perception, many states need to pay greater attention to consolidating/merging schools to make them viable rather than building new ones. At the other end of the age scale, policy makers need to prepare for ageing. This will need investments in health care as well as a plan for increasing the retirement age in a phased manner.

- **From Swachh Bharat to Sundar Bharat via Swasth Bharat**

SBM (Swachh Bharat Mission), one of the largest cleanliness drives in the world, has brought in a remarkable transformation and traceable health benefits. Even 67 years after India's independence, in 2014, around 10 crore rural and about 1 crore urban households in India were without a sanitary toilet; over 56.4 crore, i.e. close to half the population, still practiced open defecation. Through SBM, 99.2 per cent of the rural India has been covered. Since October 2, 2014 over 9.5 crore toilets have been built all over the country and 564,658 villages have been declared ODF.

Details of funds allocated and the funds released for SBM (2015-19)

Years	₹ (in Crore)		
	Funds Allocated	Funds Released	Fund Utilization (per cent)
2014-15	2850.0	2730.3	95.8
2015-16	6525.0	6363.0	97.51
2016-17	10513.0	10272.0	97.70
2017-18	16948.27	16610.9	98.0
2018-19 (RE) *	14478.1	12932.96	89.3

* (up to 31.03.2019)

Source: Ministry of Drinking Water and Sanitation

Becoming ODF has reduced deaths due to diarrhoea, malaria especially in under-five children, still births and new-borns with weight less than 2.5 kg and thereby improved child health and nutrition. This effect is particularly pronounced in districts where IHHL coverage was lower. Financial savings from a household toilet exceed the financial costs to the household by 1.7 times, on average and 2.4 times for poorest households. Going forward, SBM needs to incorporate environmental and water management issues for sustainable improvements in the long-term.

- **Enabling Inclusive Growth through Affordable, Reliable and Sustainable Energy**

India with a per-capita energy consumption of about one-third of the global average will have to increase its per capita energy consumption at least 2.5 times to increase its real per capita GDP by \$5000 per capita, in 2010 prices, to enter the upper-middle income group. Additionally, if India has to reach the HDI level of 0.8, which corresponds to high human development, it has to quadruple its per capita energy consumption. India has set ambitious targets for renewable energy and has been undertaking one of the world's largest renewable energy expansion programmes in the world. Now, globally India stands 4th in wind power, 5th in solar power and 5th in renewable power installed capacity.

Energy efficiency programmes in India have generated cost savings worth more than Rs 50,000 crore and a reduction in about 11 crore tonnes of CO₂ emission. The share of renewables in total electricity generation has increased from 6 per cent in 2014-15 to 10 per cent in 2018-19 but thermal power still plays a dominant role at 60 per cent share. The market share of electric vehicles is only 0.06 per cent in India when compared to 2 per cent in China and 39 per cent in Norway. Access to fast charging facilities must be fostered to increase the market share of electric vehicles.

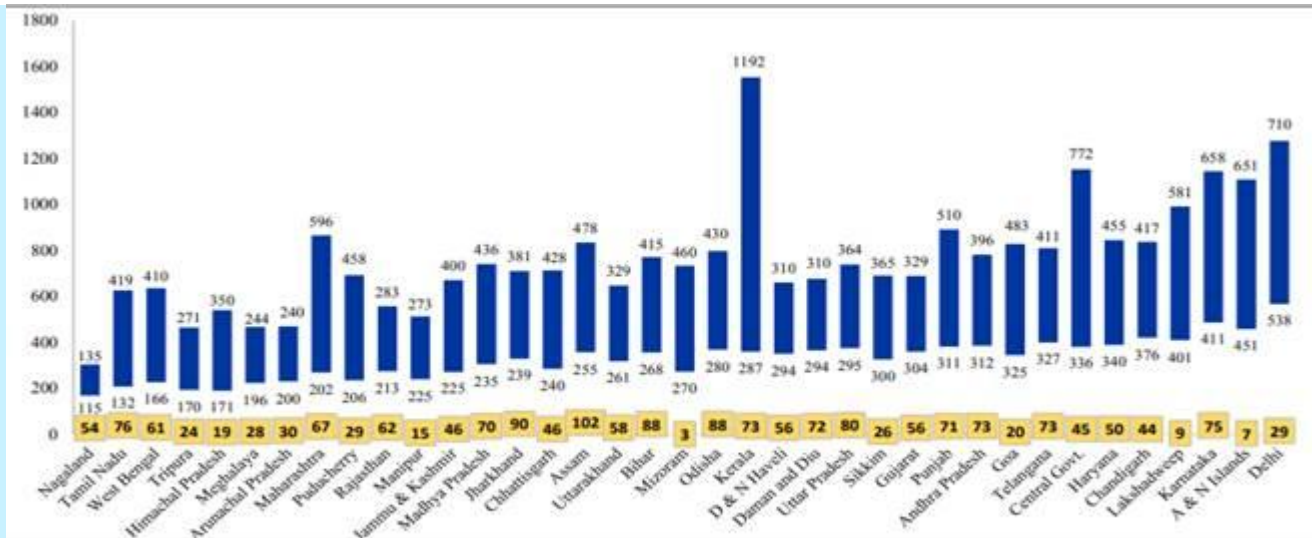
- **Effective Use of Technology for Welfare Schemes**

Use of technology in streamlining MGNREGS has helped increase its efficacy. Adoption of NeFMS and DBT in MGNREGS helped to reduce delays in the payment of wages significantly. Both demand and supply of work under MGNREGS increased, especially in districts suffering from distress. The vulnerable sections of the society viz., women, SC and ST workforce increased under MGNREGS during times of economic distress. Skilful use of technology when combined with an unwavering commitment to monitoring effectiveness of government schemes can make a substantial difference on the ground.

- **Redesigning a Minimum Wage System in India for Inclusive Growth**

The present minimum wage system in India is complex with 1,915 minimum wages defined for various scheduled job categories across various states. One in every three wage workers in India is not protected by the minimum wage law.

Range of Minimum Wages in India (Rs. per day)



Note: Figures on the horizontal axis indicates the number of scheduled employments notified under the Minimum Wage Act by the Central Government and all the States/Union Territories.

Source: PHD Research Bureau compiled from Economic Survey 2018-19

Minimum wages should be fixed for four categories namely, unskilled, semi-skilled, skilled and highly skilled based on the geographical region and should cover all workers, irrespective of any wage ceilings. A simple, coherent and enforceable Minimum Wage System should be designed with the aid of technology as minimum wages push wages up and reduce wage inequality without significantly affecting employment. An effective minimum wage policy is a potential tool not only for the protection of low paid workers but is also an inclusive mechanism for more resilient and sustainable economic development.

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