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Refueling India's Growth Story: Imperatives and Impediments

Monday, 26th August 2013 at PHD House, New Delhi

PHD RESEARCH BUREAU

PHD CHAMBER OF COMMERCE AND INDUSTRY

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2. India's WPI inflation rate was lowest at 4.7% (average) during the period FY99-03.

3. India's investment rate (GCF at current prices) was highest at 36% of GDP (average) during the period FY09-13.

4. India's FDI inflows were highest during the period FY09-13 at USD 39.6 billion (average per annum).

5. India's foreign institutional investor inflows (FIIs) were highest at USD 20.5 billion (average per annum) during the period FY09-13.

6. India's saving rate was highest at 33.2% (average) during the period FY04-08.

7. India's exports growth was highest at 25.3% (average) during the period FY04-08.

8. The increase in India's Forex Reserves was highest at USD 196.7 billion (average) during the period FY04-08.

9. India's current account deficit was lowest at (-) 0.2% (average) during the period FY99-03.

10. India's fiscal deficit was lowest at 3.6% (average) during the period FY04-08.

11. India's unemployment rate was lowest at 6.1% (average) during the period FY94-98.

India is a domestic demand driven supply constrained long-term growth story

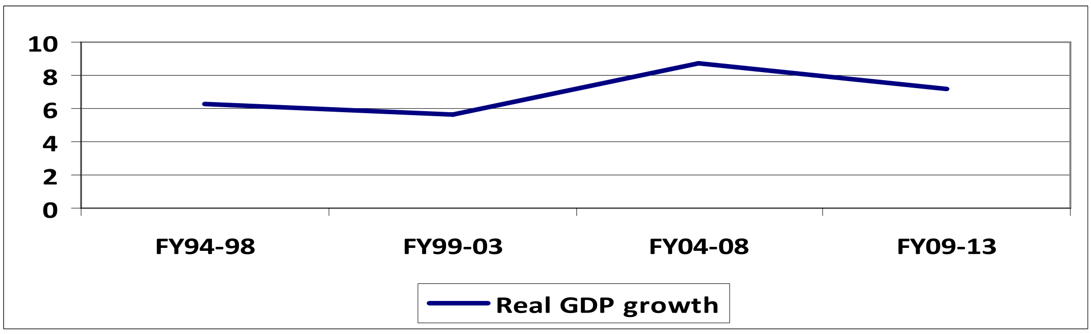
Economic policies have played a major role in scripting India's growth story and have helped to explore a greater range of growth prospects which were earlier unexplored. An abiding objective in respect of industrial policy measures since 1991 has been to create a competitive environment to improve productivity and efficiency of the industry. New industrial policy fostered competition by abolishing monopoly restrictions, terminating the phased manufacturing programmes, freeing foreign direct investment and import of foreign technology and de-reservation of sectors hitherto reserved for the public sector. These measures created a favorable environment for industry to upgrade its technology and build-up its capacity through imports in order to cater to growing domestic and external demand.

1. Post reforms growth performance

1.1 Real GDP growth

The economy has done very well on the growth front, when viewed in a long term perspective. Supported by advent of economic reforms in 1991, the real GDP growth rate improved significantly to 6.3% (average) during the period FY94-98 from 5.7% (average) in FY89-93. India's real GDP growth rate remained steady at 5.6% (average) during the period FY99-03.

Trend in growth of India's real GDP (%)



Source: PHD Research Bureau compiled from Economic Survey 2012-13

The growth rate increased significantly to a remarkable 8.7% (average) during the period FY04-08. However, due to global economic slowdown and its contagion effect coupled with home grown vulnerabilities, the GDP growth rate subsided to 7.2% (average) during the period FY09-FY13.

The growth performance so far…

Sl. No.	Components	FY94-98	FY99-03	FY04-08	FY09-13
1.	Real GDP growth (%)	6.3	5.6	8.7	7.2
2.	Per Capita Income Growth (%)	13.5	8.1	12.8	13.9
3.	WPI Inflation rate (%)	7.6	4.7	5.5	7.5
4.	FII Inflows (US$ bn)	1.9	1.3	10.6	20.5
5.	FDI Inflows (US$ bn)	2.5	4.1	15.4	39.6
6.	CAD as % to GDP	-1	-0.2	-0.3	-3.3
7.	Fiscal deficit as % to GDP	4.9	5.7	3.6	5.6
8.	Savings as % to GDP	23.1	24.7	33.2	32.6
9.	Investments as % to GDP#	23.9	25.1	33.4	36
10.	Increase in Forex Reserves (US$bn)	10.1	43.6	196.7	40.6
11.	Exports Growth Y-o-Y (%)	15.3	9	25.3	14.1
12.	Unemployment rate (%)	6.1*	7.3^	8.3^^	6.5~

Source: PHD Research Bureau compiled from various sources
*Note: The data represents average figures for the period mentioned, * Data pertains to 1993-94, ^ Data pertains to 19999-00, ^^ Data pertains to 2004-05, ~ Data pertains to 2009-10, # GCF at current prices*

1.2 Per capita income growth

The per capita income growth at current prices stood at 13.5% (average) during the period FY94-98 and 8.1% (average) during the period FY99-03. It remained steady at 12.8% (average) during the period FY04-08 and 13.9% (average) during the period FY09-13.

1.3 WPI inflation

The Indian economy witnessed an inflation rate of 7.6% (average) during the period FY94-98 and 4.7% (average) during the period FY99-03. It was 5.5% (average) and 7.5% (average) during the period FY04-08 & FY09-13 respectively.

1.4 FII Inflows

The FIIs inflows stood at US$ 1.9 billion (average) during FY94-98 and US$ 1.3 billion (average) during the period FY99-03. However, it has increased significantly to US$ 10.6 (average) billion during the period FY04-08 and US$ 20.5 billion (average) during the period FY09-13.

1.5 FDI Inflows

The FDI inflows were US$ 2.5 billion (average) during FY94-98 and US$ 4.1 billion (average) during the period FY99-03. However, it rose to US$ 15.4 (average) billion during the period FY04-08 and US$ 39.6 billion (average) during the period FY09-13.

1.6 Current account deficit (CAD)

The CAD as a percentage to GDP was (-)1% (average) and (-)0.2% (average) during the period FY94-FY98 and FY99-FY03 respectively. During FY04-08, it stood at (-)0.3% (average) and (-)3.3% (average) during the period FY09-13.

1.7 Fiscal deficit

The fiscal deficit as a percentage to GDP was 4.9% (average) and 5.7% (average) during the period FY94-98 and FY99-03 respectively. Though it declined to 3.6% (average) during the period FY04-08, but it rose to 5.6% (average) during FY09-13.

1.8 Savings

The savings as percentage to GDP (at current prices) was 23.1% (average) during FY94-98 and 24.7% (average) during the period FY99-03. It remained steady at 33.2% (average) and 32.6% (average) during the period FY04-08 and FY09-13 respectively.

1.9 Investment

The investments as percentage to GDP (at current prices) was 23.9% (average) during FY94-98 and 25.1% (average) during the period FY99-03. It has significantly increased to 33.4% (average) during the period FY04-08 and 36% (average) during the period FY09-13.

1.10 Foreign Exchange Reserves

During the FY94-98, foreign exchange reserves shows an increase of US$ 10.1 billion and an increase of around US$ 43.6 billion during the period FY99-03. Foreign exchange reserves shows an increase of US$ 196.7 billion during the period FY04-08 and an increase of US$ 40.6 billion during the period FY09-13.

1.11 Exports growth

The exports growth stood at 15.3% during the period FY94-98 and 9% during the period FY99-03. However, it has significantly increased to 25.3% during the period FY04-08 and 14.1% during the period FY09-13.

1.12 Poverty rate

India's poverty rate declines to 21.9% during the period 2011-12 from 29.8% in 2009-10. However, the poverty rate stood at 37.2% and 45.3% during the period 2004-05 and 1993-94 respectively.

1.13 Unemployment rate

The unemployment rate in India stood at 6.1% during the period FY94-98 and at around 7.3% during the period FY99-03. It stands at 8.3% during the period FY04-08, which further declines to 6.5% during the period FY09-13.

2. Current economic scenario

Presently, the domestic scenario has witnessed deceleration in almost all the lead economic indicators. The growth of real GDP has been impacted significantly in the recent times. The real GDP growth decelerated to 5% during FY 2013 as compared with 6.2% in FY 2012 and 9.3% in FY 2011. The agriculture sector in India is at crossroads with rising demand for food items and relatively poor supply side. The sector's contribution in GDP has been decelerated to around 15% during the recent years (FY09-13) from around 18% in the high growth period (FY05-FY08). The slowing of industrial output from an average of 8.7% in FY2011 to 2.7% in FY2012 and 1.1% in FY 2013 and –1.1% during April-Jun FY 2014 is raising concerns. The growth in services sector has been vibrant over the past many years, contributing sizably to India's steady growth story. However the recent slowdown in the sector from around 9.8% in FY 2011 to 7.9% in FY 2012 to 7.1% in FY 2013 is a cause of concern.

Inflation has been a major cause and challenge creating a road block to India's growth story. Average inflation remained steep at 7.4% during FY2010-13 as compared with 6.5% during FY 2007-09 and 5.5% during 2004-06. The interest rates have been on the higher trajectory with the repo-rate being raised significantly over the quarters from 5.75% in September 2010 to 8.25% in September 2011 and to 8% in September 2012, mainly in a bid to tackle the inflationary pressures in the economy. Although, the rate has been sliced to 7.25% during July 2013, it still soars high making borrowing dearer for the industrialists.

The investment situation in India is weakening. The difficulty of forecasting returns in a highly volatile economic environment, governance concerns, heightened global uncertainty, rising funding costs and structural rigidities have all played a part. While Gross domestic capital formation at current prices is estimated at Rs.31,41,465 crore in 2011-12 as against Rs.28,71,649 crore in 2010-11, constituting 35% of GDP at market prices as against 36.8% in the previous year.

Gross Domestic Saving (GDS) at current prices in 2011-12 is estimated at Rs. 27, 65,290 crore as against Rs. 26,51,933 crore in 2010-11, constituting 30.8% of GDP at market prices as against 34% in the previous year. The decrease in the rate of GDS has mainly been due to the decrease in the rates of financial savings of household sector from 23.5% to 22.3%, private corporate sector from 7.9% to 7.2% and that of public sector from 2.6% to 1.3% in 2011-12 as compared to 2010-11.

The rising global risk aversion has reduced the flow of capital. The FDI investments have been impacted significantly which is indicated from the sharp decline in FDI by (-)38% during FY2013 as compared to a robust growth of 88% during FY2012. The portfolio investments also, in terms of FIIs have shown a volatile trend causing instability in the domestic stock markets.

The exchange rate volatility has also risen significantly with the onset of world economic slowdown, with the rupee depreciating the most among the major Asian economies. The sharp depreciation of the rupee from Rs.45.6/US$ in FY 2011 to Rs.47.9/US$ in FY 2012 to Rs.54.4/US$ in FY2013 to Rs.61.43 as on 13 Aug 2013 is alarming. On the other hand concerns about global growth have impacted investors' sentiments and de-leveraging by many advanced economies has raised the cost of external finance

The gross fiscal deficit of central government as a percentage to GDP has been pegged at 5.2% for FY2013 which is another major economic challenge facing the country. The mounting subsidy burden of the government has dampened the fiscal health of the economy. Since India imports 84% of its crude oil demand and heavily subsidies domestic consumption, high prices have resulted in a widening deficit not just in foreign trade scenario, but also for the fiscal health.

In the international front, India has been placed at 132nd position in Doing Business Index 2013 and 2012 by World Bank and IFC (International Finance Corporation), up from 134th position in Doing Business Index 2011. India stands at 173 in the ranking of 185 economies on the ease of starting a business in 2013. These rankings indicate that India could do more to enhance corporate sector profitability by reducing the costs of doing business and improving institutions.

The ease of starting business in India over time

Indicator	DB'08	DB'09	DB'10	DB'11	DB'12	DB' 13
Ease of Doing Business (Rank)	120	122	133	134	132	132
Starting a Business (Rank)	111	121	169	165	169	173
Procedures (no)	13	13	13	12	12	12
Time (days)	33	30	30	29	29	27
Cost (% of per-cap income)	74.6	70.1	66.1	56.5	46.8	49.8

Source: PHD Research Bureau, compiled from Doing Business reports World bank and IFC

3. Economic outlook 2013-14 (PHD Chamber Viewpoint)

Although the world economy is showing some signs of a recovery, the real recovery is expected to be long drawn, where consumption may not keep pace of the earlier levels. In case of the Indian economy, the current situation is expected to improve in the ensuing months and we are anticipating the real GDP growth to scale up to around 6% in 2013-14. While growth in IIP and services sector is expected to recover in the ensuing quarters, recovery is expected to be slow on the external side.

We assume that WPI inflation will hover around 5-6% (average). With the moderation in inflation scenario, we expect a relatively easy money policy ahead. Softening of interest rates vis-à-vis easy money policy will attract capital flows and help rupee to appreciate and stabilise.

Economic outlook so far

Sr. No.	Indicators	2013-14 Projections
1	Real GDP	6%
2	Agriculture	4%
3	Industry	4%
4	Services	7%
5.	WPI inflation	5.5%
6.	Fiscal deficit	5%
7.	Current Account Deficit	4.5%

The progress of the monsoon has also been encouraging. Progress in kharif crops sowing vis-à-vis good monsoon behaviour coupled with softening global commodity prices will stabilize inflationary scenario at around 5.5% and should pave the way for turnaround in the economic growth.

We believe the focus of the government on the agriculture sector will continue and agriculture sector will emerge as a key growth driver of the economy, not only in this year, but in the coming years too. Improvements in the sector will not only help in meeting the supply side pressures, but will also aid in stabilizing the overall macro-economic scenario.

The industry growth is set to pick up in the ensuing months, supported by easing liquidity conditions in the economy. Softening of lending rates will enhance consumer goods demand as well as improve private investments from both domestic and foreign investors. We believe the services sector scenario will improve on expansion in the services sector activities in the emerging and developing economies.

Softening inflation and interest rates and pick up in the economic growth will help attract foreign investors once again and the capital flows are expected to rebound in the coming months by the Q3 FY2014. We expect rupee to stabilize in the Q3 FY2014 with stability in the macro economic setup and a rebound in capital flows.

With pick up in economic growth and revenue collection, fiscal deficit to GDP will stabilize at around 5%. However, current account deficit may continue to hover at around 4-4.5% of GDP.

In summary, the prospects of the Indian economy look bright this year with the expectation of more consolidated growth and macro economic stability. However, issues relating to policy implementation and administrative roadblocks needs to be addressed immediately which will help the economy grow faster and attain its potential growth rate, going forward.

4. Refueling growth

The Indian economy, and Indian industry, today faces the most serious crisis since 1991. The industrial recession is particularly worrying in the context of India's international standing. India achieved such a high growth in the last decade that it was on way to becoming the world's third largest economy. The India growth story was thrown off track by the global financial crisis which engulfed virtually every country in the world. However, domestic factors like persistent inflation, inadequate policy action and problems on implementation fronts magnified the slowdown in growth scenario. Today, the growth rate is falling rapidly, and India's position in world league tables is going down.

Against this backdrop, the PHD Chamber looks forward to the effective policy interventions and reform initiatives that would pave the way to **REFUEL GROWTH** trajectory in the coming times. To refuel growth trajectory, PHD Chamber suggests the following measures.

1. **Improving agriculture productivity --** The agriculture sector in India is at a crossroads with rising demand for food items and relatively slower supply response in many commodities resulting in frequent spikes in food inflation. The sector's contribution in GDP has been decelerated to around 15% during the recent years. Notwithstanding, the growth of agriculture and allied sectors is still a critical factor in the overall performance of the Indian economy as it accounts for about 53 per cent of employment in the country. Besides, agriculture has very vital supply demand linkages with other sectors of the economy. Raising agricultural productivity is, therefore, important for containing price pressures, raising rural incomes and making growth more inclusive.

2. **Encouraging industrial growth --** Although the industry growth process has been to some extent influenced by global business cycles, the persisting deceleration in industrial growth is, in part, attributed to the slowdown in reform momentum and inadequacy of certain major structural reforms in the domestic economy. In an increasingly global environment, the sector continues to face structural constraints, such as

inadequate, relatively inefficient and high cost infrastructure, high cost of borrowed funds, inflexibilities in labour markets and other institutional rigidities that inhibit the pace of industrial restructuring. Going ahead, acceleration in industrial growth to double digit levels is essential for the achievement of 8% GDP growth as targeted in the Twelfth Five Year Plan. The removal of the remaining rigidities in the industrial sector would not only regenerate the required production growth but also promote much greater industrial employment.

3. Revitalizing services sector growth -- Services account for nearly 60% of India's GDP. The growth of India's economy is presently driven by services sector and with in services sector by IT and ITES sector. Strong demand over the past few years has placed India amongst the fastest growing IT markets in Asia –Pacific region. However, recession in some countries of euro zone and stuttering growth in the United States has dampened demand for Indian services.

There is a need to diversify the services export basket which is currently dominated by IT and ITES exports, and even India needs to explore new destinations for its exports in addition to the USA and Canada, which account for large chunk of its software exports. Further, the potential of domestic market need to be tapped.

4. Bridging the infrastructure deficit -- It is widely acknowledged that infrastructure deficit is by far one of the most binding constraints to accelerating growth. Even so, our efforts to bridge the deficit have fallen way short of the task. The Twelfth Plan projects investment over the five year period 2012-17 to $1 trillion and anticipates for 50 per cent of the projected investment to come from the private sector and much of the project implementation to happen in the PPP mode. Infrastructure investment, therefore, poses three sub-challenges: mobilizing the necessary resources, reforming regulations and contractual arrangements and efficient project planning and execution.

5. Focusing on energy sector reforms -- Reforms in the energy sector are also the need of the hour. Disparities in the pricing mechanism, slow policy reforms, unattractive fiscal regime and inadequate infrastructure pose a threat to energy security. The demand for coal has continuously grown which is amounting to the rising current account deficit (CAD). It has been estimated that coal imports may expand significantly in coming years and this would further trigger India's burgeoning CAD. India currently faces a massive shortage of coal which is jeopardizing the functioning of the power sector and other end-use sectors. Thus, there is a need to introduce competition in the coal sector, along with the involvement of mine development operators, who will infuse both capital and technology in the mining sector and help in boosting our domestic production.

To match the demand-supply gap of energy requirement, reforms in coal sector is essential to take our country forward. Coal plays significant role in India's industrial output growth, as our industries are largely dependent on indigenous coal production and around 66% of India's power generation is coal based. There is enormous potential for coal exploration in India, but the resources are largely untapped while many projects remain under implemented due to procedural hassles. Thus the coal sector in India promises tremendous avenues for investors which could be harnessed to pave the way towards a sustainable and environment friendly economic growth.

6. Stabilization of foreign trade policy regime -- The Indian export performance has been commendable and the government is making efforts to keep up the growth momentum. The recent diversification of export destinations from advanced economies to emerging markets has helped exports to post comfortable growth vis-à-vis global economic slowdown. However, there is a need to ensure policy stabilization to hedge the exporters from rampant currency fluctuations taking place in the international markets.

The recent crisis in the advanced economies has led to massive turbulence in the exchange rates which has seen the rupee depreciate significantly against the dollar. The volatility in exchange rates is preventing the Indian exporters from making long term business decisions which may affect momentum of exports growth, going forward. Hence a stable policy frame work must be drafted so as to facilitate them in their long term decision making.

7. Focusing skill development -- In order to revisit growth in the economy, it has become crucial to bring more and more of our labour resources in the production chain by improving the skill sets in the economy**.** In fact, our industry is facing an acute shortage of skilled manpower in various sectors including ITES, biotechnology, healthcare, food processing and construction, among others. According to NSSO, around 13 million workers enter the market every year and only 3 million are skilled. Against this backdrop, we should focus, through a mission mode approach, adequate skill development programmes with proper outcomes so that the existing projects are completed on time without hindrances.

8. Rationalization and simplification of tax system -- There is need to inject stability in tax rates-direct and indirect-in order to boost the confidence of both domestic and international investors. Both DTC and GST aim to bring about simplification in tax structure by removing current inefficiencies/distortions so as to provide a more enabling environment for the Indian corporate sector.

The government must not let the impasse on GST to stay for long and should complete the legislative process and resolve all pending issues. This will enable existing players to plan their projects and factor in their cost of operation. The Government should utilize this interval for preparing IT infrastructure and developing a consensus on final rates, exemptions etc to smoothen the implementation process. The implementation of GST will provide a more enabling environment for India's trade and industry and lead to a single common market across the Indian states. Similarly, the introduction of the Direct Tax Code Bill will facilitate reforms in direct taxes regime.

9. Promoting good governance -- Good governance is at the very heart of economic growth and poverty reduction. It is the quality of governance that separates success and failure in economic development. Across countries, application of the same policies in roughly similar contexts has produced dramatically different results. In our own country, we have seen vast differences across states in development outcomes from out of the same mix of development policies. These differences across countries as well as across regions within countries, even as they adopt similar policy packages, arise because of differences in governance. Indeed research shows that per capita incomes and the quality of governance are strongly correlated indicating a virtuous circle in which good governance results in economic development.

5. Conclusions

India will continue to deliver steady growth, supported by strong demand conditions, rising incomes and favorable demographics. However, the country has potential to grow in the much higher trajectory, but this requires further structural reforms and accelerated implementation. In our view, structural reforms are a must if growth is going to pick up in faster pace and if double-digit growth is ever to materialise, going forward.

With this backdrop, PHD Chamber looks forward to rapid economic reforms in the country, which prioritizes on stabilizing the volatile macro-economic environment to retain the confidence not only of the investors but also various other socio-economic segments whose sentiments are impacted by volatility in economic system.

The Chamber hopes that the stability in the macro economic system would spur us on to articulating clear priorities in the coming times and for building a consensus towards speedy socio-economic development of the country.

India: Statistical snapshot

Indicators	FY09	FY10	FY11	FY12	FY13
GDP at FC - Constant prices Rs Bn	41,586	45,160	49,370	52,435	55,034*
GDP at FC - Constant prices growth YoY	6.7	8.6	9.3	6.2	5*
GDP at MP-current prices Rs. Bn	56,300	64,778	77,953	89,749	1,00,281*
Agriculture growth	0.1	0.8	7.9	3.6	1.9*
Industry growth	4.1	10.2	8.7	2.7	1.1*
Services growth	9.4	10.0	9.8	7.9	7.1*
Domestic Consumption	5.4	5.3	8.7	6	5.0
Private consumption	7.1	7	8.1	5.5	5.0
Gross domestic savings as % of GDP	32	33.7	34.0	30.8	31.8
Gross Fixed Capital Formation as % of GDP	32.3	31.7	31.7	30.6	29.6*
Gross fiscal deficit of the Centre as a % GDP	6	6.5	4.8	5.7	5.2
Gross fiscal deficit of the states as a % GDP	2.4	2.9	2.1	1.9	2.3
Gross fiscal deficit of Centre & states as a % GDP	8.4	9.4	6.9	7.6	7.5
Merchandise exports (US$Bn)	185.3	178.7	251.1	305.9	300.57^
Growth in exports	3.4	-3.6	40.5	21.8	(-)1.86^
Imports (US$Bn)	303.6	288.3	369.7	489.3	491.48^
Growth in imports (YoY)	14.3	-5.0	28.2	32.3	0.44^
Trade deficit (US$Bn)	118.4	109.6	118.6	184.8	190.91^
Net invisibles US$Bn	91.6^^	80.0	79.3	111.6	107.5
Current account deficit US$Bn	28.7	38.4	44.3	78.2	87.8#
Current account deficit as % of GDP	2.6	3.2	2.6	4.2	4.8#
Net capital account US$Bn	8.7	53.4	60	67.8	94.2^^
Overall balance of payments US$Bn	20.1	-13.4	-13.1	12.8	-3.8
Foreign exchange reserves US$Bn	252	279.1	304.8	294.9	292.04~
External debt - Short term US$Bn	43.4	52.3	65	78.2	96.7
External debt - Long term US$Bn	181.2	208.7	240.9	267.5	293.4
External debt - Gross US$Bn	224.5	261	305.9	345.7	390.0
Money supply growth	19.3	16.9	16.1	13.2	13.8
Bank credit growth	17.5	17.1	21.2	16.8	13.4
WPI inflation	8.1	3.9	9.5	8.9	7.4
CPI inflation	7	12.4	10.4	8.4	10.4
Exchange rate Rs/US$ annual average	46	47.4	45.6	47.9	54.4

*Source: PHD Research Bureau compiled from various sources, *Data pertains to provisional estimates of national income 2012-13 MOSPI,^ Data pertains to Apr-Mar 2012-13 from Ministry of Commerce and Industry, ^^Data pertains to 2012-13 from PMEAC economic review, ~ Data pertains to end March, 2013 from RBI Annual Report 2012-13, # Data pertains to India's Balance of payment end March 2013 from RBI.*

We are thankful to our Chairman and Co-Chairman for providing Lunch and Logistics Support

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