



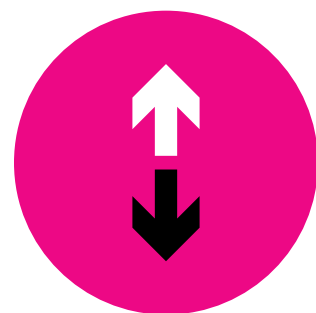
INDIA'S ECONOMY MIGHT BE CRUISING ALONG, BUT THE ROAD AHEAD MIGHT NOT BE SO SMOOTH.



THEY SAY CAMPAIGNS ARE run on promises but governance is judged by performance. Or as former New York governor Mario Cuomo put it more eloquently: "One campaigns in poetry but governs in prose." India is a classic example of this political truism. In the over 70 years since independence, its unforgiving voters have thrown out governments that have failed to deliver on their promises: The Congress party lost power in 1977 after former prime minister Indira Gandhi imposed an Emergency and the Bharatiya Janata Party (BJP) suffered a shock defeat in 2004 after its 'India Shining' campaign failed to resonate with people. As the National Democratic Alliance's (NDA) term draws to a close and India gears up for a critical general election, Prime Minister Narendra Modi's government will also be judged for what it has achieved and not what it had promised.

BY **ASHISH GUPTA**
ILLUSTRATION BY **ANIRBAN GHOSH**





WHEN MODI SWEPT the 2014 general election, he promised to deliver good governance and *achche din* or good days. Five years down the road, the question many are asking is: Has the NDA government delivered on its economic promises? Some economists and corporate head honchos say that on virtually all macroeconomic parameters, the Indian economy of FY20 is in a far better shape than the second innings of the Congress-led United Progressive Alliance (UPA) of 2009-2014, or UPA II, which was hobbled by policy paralysis, rising inflation, charges of corruption, and fighting between alliance partners.

India is one of the world's fastest-growing major economies with robust growth across sectors. According to the government's revised GDP growth estimates released last November, the \$2.61 trillion economy grew much faster under the NDA than it did under the previous UPA administration. After the revision, average growth in the UPA years declined to 6.82% from 7.75% earlier, much lower than the 7.35% during the four years of the current government. The Modi government has also successfully reined in the inflation genie: Average inflation under the UPA II was at an alarming high of 10.1% while the NDA government has brought it down to a more manageable 4.6%. Other economic indicators tell a similar story. The fiscal deficit, which stood at 4.1% in the last year of the Manmohan Singh government, is expected to come down to 3.4% in FY19 and remain at the same level next year, too. Foreign direct investment touched \$239 billion in the past five years and external debt as a percentage of total debt fell from 8.92% in March 2014 to 6.2% last December.

It's not just dry statistics, but anecdotal evidence also suggests that India's economic engine is humming. Look at consumer spending. India's growing middle class and the huge millennial population are spending like there's no tomorrow: Smartphones are flying off the shelves, people are changing cars without a thought, the upwardly mobile are constantly jetting off on expensive holidays, and cafes and bars in cities are packed with affluent urban Indians busy sipping their lattes and proseccos. India's growing consumption has even enticed some of the biggest global

companies such as IKEA and Walmart to set up shop here. "The economic reforms undertaken have unshackled the Indian economy, unleashed its potential and made us a global leader in growth. India is the fastest growing major economy in the world and is becoming a nation where it is easier to do business," finance minister Arun Jaitley wrote in his blog. NITI Aayog vice chairman Rajiv Kumar echoes the sentiment. "I can challenge anybody to show me any other period of five years where more has been done to improve the economy than under the NDA government," he tells *Fortune India*.

But hold on, it isn't quite time to pop the champagne yet. The strong statistics mask some harsh realities: Asia's third-largest economy has been a bit wobbly of late with the promised double-digit growth nowhere in sight, it is facing its worst jobs crisis, the agrarian sector is distressed, real estate is subdued, banks are saddled with back-breaking bad loans, the airline sector is plummeting rapidly, and the stock market is just about recovering from a bloodbath last year. India has yet to emerge as a global manufacturing destination despite the high-voltage 'Make in India' campaign; the export sector continues to languish because of an adverse global environment and the power sector is still struggling with high transmission and distribution losses.

India's economy might seem to be cruising along, but a host of risks could stop it in its tracks. Look at some numbers on the flip side: The most recent growth figures suggest the economy could be slowing down with GDP growing 6.6% in the October-December quarter of FY19, the lowest in the last six quarters. The rupee's sharp fall has also cast a cloud on the economy. It was Asia's worst performing currency last year, dropping more than 16%, which combined with surging crude oil prices not only pushed the current account deficit (CAD) to 2.5% of GDP but also bumped inflation up to 4.9%. Worse, the corporate sector's profit as a percentage of GDP has been falling and is at just 2%-3% levels today. The private sector, which accounts for 74% of the country's total



RPG Enterprises chairman Harsh Goenka (left) and Mahindra & Mahindra managing director Pawan Goenka feel the bankruptcy code and GST have been major positives.

investment pie, is wary of investing as it is still not confident of a demand pickup. Moreover, attempts to rescue the real estate and construction sector through a reduction in the goods and services tax (GST) on under-construction houses and lower taxes on affordable housing to mitigate the impact of demonetisation and the implementation of the GST is a case of too little too late. The economic woes don't end here. The country may also be looking at a ₹1.5 lakh crore shortfall in gross tax receipts in FY20, according to a report by broking firm Motilal Oswal. In an election year, the fallout of aggressive public spending to woo voters by the government and promises by other political parties can spook international markets and investors, and create inflationary pressures.

MOUNTING WOES

PERHAPS THE BIGGEST drag on the economy is the high non-performing assets (NPAs) of public sector banks despite the government pumping in ₹2.6 lakh crore for the recapitalisation of these lenders over the past 10 years. Former finance minister P. Chidambaram told a press conference recently gross NPAs have risen from ₹2,63,015 crore to ₹10,30,000 crore and will rise more. "The banking system is practically bankrupt. I have not come across a banker who will willingly sanction a loan;

nor an investor who will confidently borrow money," he said.

Despite the BJP's promise to galvanise the economy and create millions of jobs, the government isn't set for an economic victory lap ahead of the election. Gross capital formation, or investment in plant and machinery, has dropped from 34.3% of GDP in 2014 to 31% following the shock demonetisation move and the shoddily implemented GST. Even the government's Economic Survey acknowledges that demonetisation knocked off at least 1% from the growth rate, though International Monetary Fund (IMF) chief economist Gita Gopinath pegs the figure higher at 2%, a huge loss in national income. The employment scenario too seems rather grim with the latest National Sample Survey Office report pegging the unemployment rate in 2017-18 at 6.1%, the worst in 45 years. The numbers were a blow to the BJP but the government rejected the controversial report published by *Business Standard*, saying it was still in "draft" form.

For the NDA government, the economic woes couldn't have come at a worse time. Some economists have questioned the sanctity of the statistics from government agencies because of the constant revision of figures. For instance, the RBI Handbook of Statistics on the Indian Economy for 2017-18 published in September 2018 put the average annual GDP growth rate between FY14 and FY18 at 6.8%, but the government later revised the number to 7.3% and then to 7.7%. Surprisingly, the announcements were made by the government think tank NITI Aayog and not the Central Statistics Office. No wonder, 108 economists and social scientists across the world came out with a joint statement alleging that the government was interfering with the country's statistics-gathering agencies. They said Indian statistics and the institutions associated with it have "come under a cloud for being influenced and indeed even controlled by political considerations". The government has dismissed the controversy over allegations of fudging of statistics.

THE ROAD TO REFORM

MANY ECONOMISTS ARE sceptical about the economic health of the country. With domestic growth slowing, private investment still to pick up, and the external environment looking rather grim, it is difficult for India to achieve double-digit or even 9% growth in the near future. "History and various studies show that unless exports grow at 20% or more year-on-year, it is difficult for the country to achieve 9% or double-digit growth. And that seems highly unlikely not just because the votaries of free trade like the U.S. and the European Union have turned protectionist, but also because their economies too are slowing down," says Sunil Sinha, principal economist at rating firm India Ratings and Research. The European Central Bank (ECB), for instance, has already scaled down the EU's growth forecast from 1.7% to 1.1%, China has cut its estimate from 6.5% to 6%, and the threat of a no-deal crash-out from the EU for Britain is still on the cards.

However, even the government's most vehement critics agree the Modi government has carried out some transformational reforms, though their implementation may be open to question. Corporate India says GST and the bankruptcy code have the potential to dramatically change the economic landscape of the country as it looks to step up growth. Businessmen also cheered the inflation-targeting mechanism for the central bank as it will help rein in inflation. "For me, the three major positives are the GST, because it will bring long-term benefits to the economy; transparency in government decision-making, which has brought down corruption levels at the Centre if not in the states; and finally the implementation of the Insolvency and Bankruptcy Code (IBC) of 2016, which has ensured that promoters who default cannot take the system for granted any longer, and there are promoters who will lose control of their companies," says Harsh Goenka, chairman

of the diversified RPG Enterprises. "By providing an independent, time-bound resolution mechanism, the IBC is changing the credit behaviour in the industry and in that sense alone is hugely progressive," adds Zarin Daruwala, CEO of Standard Chartered Bank India.

For Marico Ltd chairman Harsh Mariwala, other than GST and the IBC, the third success story of the present government is its focus on infrastructure development. Daruwala agrees, saying the focus on highways, rural roads and the like are a "big positive" because it will significantly reduce logistics costs of trade and improve efficiencies. Pawan Goenka, managing director of auto major Mahindra & Mahindra, sees the setting up of the Monetary Policy Committee for inflation targeting in the Reserve Bank of India (RBI) as a seminal reform because it will keep inflation in an acceptable range. "This will keep interest rates from spiking suddenly and hurting borrowers. Importantly, this framework will impart stability to growth that in turn will act as a magnet for higher investments—both global and domestic," he says.

The NDA government might have pushed through several reforms during its tenure but it isn't enough. India remains the poorest among the G-20 countries and 7%-7.5% average GDP growth is not enough to raise millions from poverty. Moreover, the benefits of the growth are highly skewed with the top 1% enjoying 21% of the total income and the bottom 50% having only 14.6% of the income, according to the World Inequality Database developed by well-known economist Thomas Piketty of the Paris School of Economics and his colleagues. This great divide is manifested not just in protests by distressed farmers but also by better-off sections of the population for job reservations.

Given the potential pitfalls, India needs reforms in jobs, labour, land and agriculture, trade, and privatisation to take the economy to the next level. For example, focussing on getting land records in place and making farmers a part of the development process—like the Andhra Pradesh model of



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▲ PHOTOGRAPH BY NARENDRA BISHT

land pooling—could make land acquisition much simpler, and help in industrialisation and job creation. Most experts believe the government needs to kick the stuttering disinvestment process up a notch to shore up its finances. "The role of government in terms of privatisation hasn't worked out as expected, so that area needs to be pushed as well," says Mariwala. NITI Aayog's Kumar agrees: "If the government were to combine and divest Bharat Sanchar Nigam Ltd and Mahanagar Telephone Nigam Ltd together, it could get a much better price than selling them separately."

The IMF says India is one the world's fastest-growing large economies which has carried out several key reforms in the last five years but more needs to be done. "India has, of course, been one of the world's fastest-growing large economies of late, with growth averaging about 7% over the past five years," media reports quoted IMF communications director Gerry Rice as saying at a recent news conference. "Important reforms have been implemented and we feel more reforms are needed to sustain this high growth, including to harness the demographic dividend opportunity, which India has."

Kumar adds the focus should be on reforms at the state level because different states have different needs. "Having a pan-India reform or strategy will not work because each state has different needs and requirements," he argues. The only way to get the states to implement progressive reforms is to ensure that they compete with one another so that they can reap the "democratic dividend", he says.

As India prepares for a new government, investors are increasingly jittery about the state of the economy. With foreign direct investment inflows dropping, chief economic advisor Krishnamurthy Subramanian reassured investors about policy continuity, saying the election process will not stop India's reform process. But with several challenges staring at the new government, what is the way ahead for the economy? *Fortune India* has some suggestions for the next administration to help it propel



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CHAIRMAN, GODREJ GROUP



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PRINCIPAL ECONOMIST, INDIA RATINGS AND RESEARCH

India's growth story to a higher trajectory.

One of the new government's priorities should be to bring down the CAD, which has shot up because of global factors such as high global oil prices and the depreciation of the rupee. India's economy is highly sensitive to sharp swings in global crude oil and other commodity prices, and is dependent on unreliable and volatile capital flows to fund its CAD. The CAD jumped from 1.8% of GDP in FY18 to 2.7% in the first half of FY19 and is pegged at 2.5% in FY19. In order to ensure that the CAD is financed predominantly by more stable capital inflows like foreign direct investment and non-resident Indian deposits, it needs to be brought down to a sustainable range of 1.5% to 2.5% of GDP, says Sajjid Chinoy, chief India economist at JPMorgan Chase.

The new government needs to increase FDI inflows through easier regulatory and tax regimes that make it simpler for global players to do business in India. As Adi Godrej, chairman of the Godrej Group, points out: “The one thing that the next government should continue to focus on is to improve the ease of doing business. Some good work has been done by the present government, but more needs to be done.”

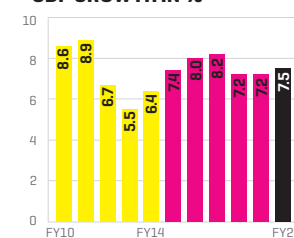
India also needs to improve its creaking infrastructure as it is a key factor hobbling economic growth. If the 2017 Asian Development Bank report titled 'Meeting Asia's Infrastructure Needs' is any indication, the country will need to add another \$112 billion every year to its existing spend (another 4% of its GDP) for the next five years to develop infrastructure facilities to join the ranks of middle-income nations. Building a vast network of rural roads and highways, ports, and airports for a cash-strapped economy can be a challenge as nearly 24% of total private sector capital investment is still stuck in stalled projects, according to Centre for Monitoring of Indian Economy data. “Till those projects are freed up or untangled, fresh investments from these firms is highly unlikely, even though other companies have started investing,” says NITI Aayog's Kumar.

Finding the right public-private

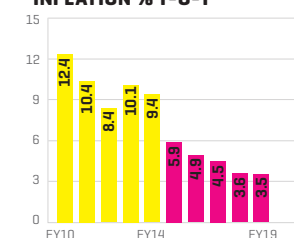
THE ECONOMY REPORT CARD

NDA has a better record than UPA II on most parameters.

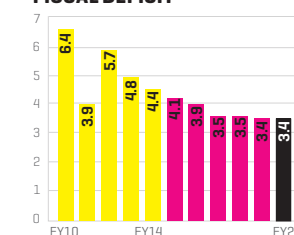
▶ GDP GROWTH IN %



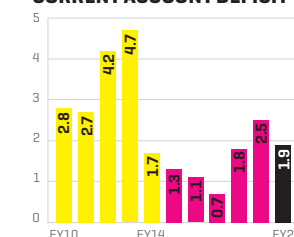
▶ INFLATION % Y-O-Y



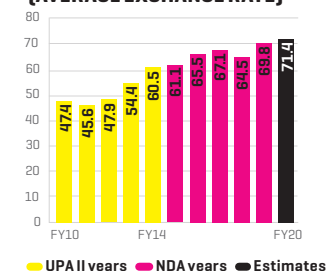
▶ FISCAL DEFICIT*



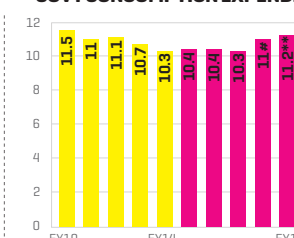
▶ CURRENT ACCOUNT DEFICIT*



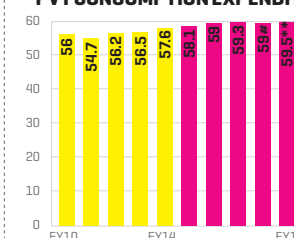
▶ RUPEE-DOLLAR EXCHANGE RATE (AVERAGE EXCHANGE RATE)



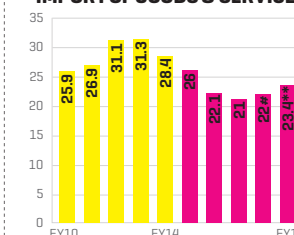
▶ GOVT CONSUMPTION EXPENDITURE*



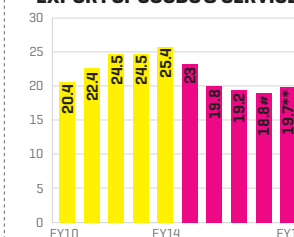
▶ PVT CONSUMPTION EXPENDITURE*



▶ IMPORT OF GOODS & SERVICES*



▶ EXPORT OF GOODS & SERVICES*



● UPA II years ● NDA years;
*as % of GDP; #Revised Estimates;
**Advance Estimates

\$239
BILLION

Total foreign direct investment
in the past five years

SOURCE: CSO DATA, INDIA RATINGS, RBI, AND INTERIM BUDGET 2019-20

partnership (PPP) model could well be the key to bridging the country's infrastructure deficit. The government can raise finances by removing exemptions and distortions in GST, selling government assets like spectrum to telecom players, better sale of profitable and loss-making public sector units to private players, and monetising the government's excess land. For example, the government recently transferred completed road projects to the private sector for collecting toll, operating it and finally transferring the project back to itself for a price; the money is now being used to build new roads.

REINING IN THE FISCAL DEFICIT

SIMILARLY, THE GOVERNMENT can sell completed projects to domestic and foreign institutional investors who have long-term liabilities but a limited appetite for risk. Taking a cue from the experiences of countries like Japan and Korea, the government has for the first time leased out the adjoining land next to the Hyderabad Metro project to Larsen & Toubro for 60 years for commercial activity. More importantly, like many other developed nations in the world, the country needs to build a vibrant corporate bond market for financing long-term projects and not just depend on banks for funding.

Keeping the fiscal deficit within manageable limits is of utmost importance for a relatively poor country like India. A sustainable fiscal deficit will help keep inflation low, leave enough money in the hands of private players for investment, and insulate the economy when global headwinds turn turbulent. Yet in the past five years of the NDA government, there has been little fiscal consolidation despite the unexpected bonanza from low commodity prices and bumper crops from FY15 to FY18. Instead, the government has resorted to the use of extra-budgetary resources (EBR) to meet its ever-growing expenditure while keeping its fiscal numbers in check. In the case of EBR, financial liabilities are raised by public

sector units like National Bank for Agriculture and Rural Development (NABARD) and Food Corporation of India for which repayments are made later using government budgets. So instead of the liabilities sitting in government accounts, they are lying in the balance sheets of the PSUs. States should be incentivised to keep their fiscal deficit in check because they are increasingly breaching their borrowing limits. "There is a need for better accounting for contingent and off balance sheet liabilities of the state and the Centre to estimate the overall government financing need and therefore its claims on savings," contends Raghuram Rajan, former RBI governor and now professor of finance at the University of Chicago, Booth School of Business.

KICKSTARTING THE ECONOMY

WITH THE 2019 GENERAL and state elections around the corner, the Centre and various state governments have announced farm loan waivers and sops for the distressed agrarian sector. These handouts will become the biggest challenge for the new government as loan waivers can be a big drag on the economy. "It [a loan waiver] ruins the exchequer, upsets the macroeconomic balance, depresses overall investment, and damages the credit culture among rural borrowers, without which formal lending to the farm sector would be hurt," explains Nilanjan Banik, professor of economics at Bennett University.

Farmers, the mainstay of the economy, need a package of measures to boost productivity such as better irrigation and storage facilities like cold chains. For Mariwala, technology can go a long way to improve productivity just like the telecom sector and the launch of mobiles. For Kumar of NITI Aayog, the only way to get the agriculture cycle moving again is to export surplus grains, even if it means subsidising them. But, more importantly, the government must provide remunerative prices to farmers while keeping food inflation low. The agrarian crisis is partly the result of the government's decision not to hike minimum support prices for the first three years while input costs kept going up, hurting the real income of farmers.

With GDP growth slowing to 6.6% in the third quarter of FY19, many experts believe the economy needs a kickstart or a stimulus package to get the growth momentum going. It is particularly important as companies are spending cautiously in the current economic climate. "I would think that there is a need for some kind of stimulus to bolster the economy since investments are not happening," says Mariwala. "Earlier, boards of companies would be okay with stretching spending budgets to grow revenue. But the mood is one of conservatism right now where the bottom line has taken precedence over growing top line," adds Harsh Goenka.

But Pawan Goenka is more optimistic and believes

₹12
LAKH CRORE

Total tax collections expected
in financial year 2018-19

₹6.38
LAKH CRORE

Total tax collections in
financial year 2013-14

both the RBI and the government are now giving growth a priority by "pressing both monetary and fiscal levers simultaneously". While he does not see the private sector getting squeezed out of the market because of high government borrowings, he believes the government needs to ensure availability of credit at a reasonable cost as credit demand is beginning to pick up.

Harsh Goenka points out that owing to growing protectionism and the on-going trade wars, the export market is on the softer side now, resulting in greater competition for the domestic market. "It will further hinder companies' ability to pass on the increase in raw material and other input costs to consumers. So there is a profit squeeze that is happening as far as the corporate sector is concerned," he says.

What, then, is the mood of the corporate sector and economists as the nation goes into the next general election? Clearly, the overriding sense is one of cautious optimism, but the consensus is that India is on a fairly steady wicket. The one big hope: a stable government at the Centre. ■

*Additional reporting by
Sourav Majumdar and Aveek Datta*