Recent Policy Developments and Growth Prospects in India: Opportunities for East Asia Summit Countries

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Synopsis

- The global economy is passing through a turbulent time. Major economies are likely to experience recessionary or low-growth phases. China is also expected to face the lowest GDP growth rate in the last three decades.

- However, India has been able to weather global headwinds. It has been one of the fastest growing large economies in the post-Covid period and has emerged as the world's fifth-leading economy. Given its strong economic fundamentals, India's growth momentum is likely to continue in the near future, although at a relatively moderate rate.

- Backed by several structural reforms and initiatives in the past few years, India's growth prospects offer a ray of hope for the rest of the world, including opportunities for East Asia Summit countries to enhance their trade and investment relations.

The global economy is in challenging times. After witnessing a negative growth of 3.1 percent in 2020, the world economy has expanded by six percent in 2021. However, owing to multiple geo-economic factors, growth momentum has been losing steam. The world economy is estimated to grow by 3.2 percent in 2022 and further decrease to 2.7 percent in 2023.[1] Most of the major economies, such as the US, Germany, and the UK, are likely to head towards a recessionary or a very low growth phase. China's GDP growth rate is also expected to be the lowest in the last three decades.

Although India was also among the major economies hardest hit by the Covid-19 pandemic in 2020, it has exhibited a significantly higher economic growth rate than the world's major economies during the post Covid-19 years of 2021 and 2022. Owing to its strong economic fundamentals and various policy measures introduced by the government in recent years, India is likely to remain one of the fastest growing major economies in the near future. Having emerged as the world's 5th largest economy and the second leading host of working age population and soon to be the first, India's growth prospect seems relatively bright and offers great opportunities to the rest of the world, especially to East Asia Summit economies.

India's GDP contracted by 6.6 percent in 2020, which was almost in line with the negative growth observed in many other large economies due to the outbreak of the Covid-19 pandemic. However, India bounced back with a growth rate of 8.7 percent in 2021, which was the highest among the world's major economies, as can be observed in Table 1. With a growth rate of 6.8 percent, India is likely to be the second fastest-growing economy in 2022 and the top performer in 2023, although the growth rate would be slightly modest. The latest projections (September 2022) by the Reserve Bank of India (RBI) also show that India's real GDP would grow by 7.0 percent in 2022-23 and 6.5 percent in 2023-24.[2]

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[1] IMF, 2022

[2] RBI, 2022

Table 1: GDP Growth Rate in India and Other Major Economies

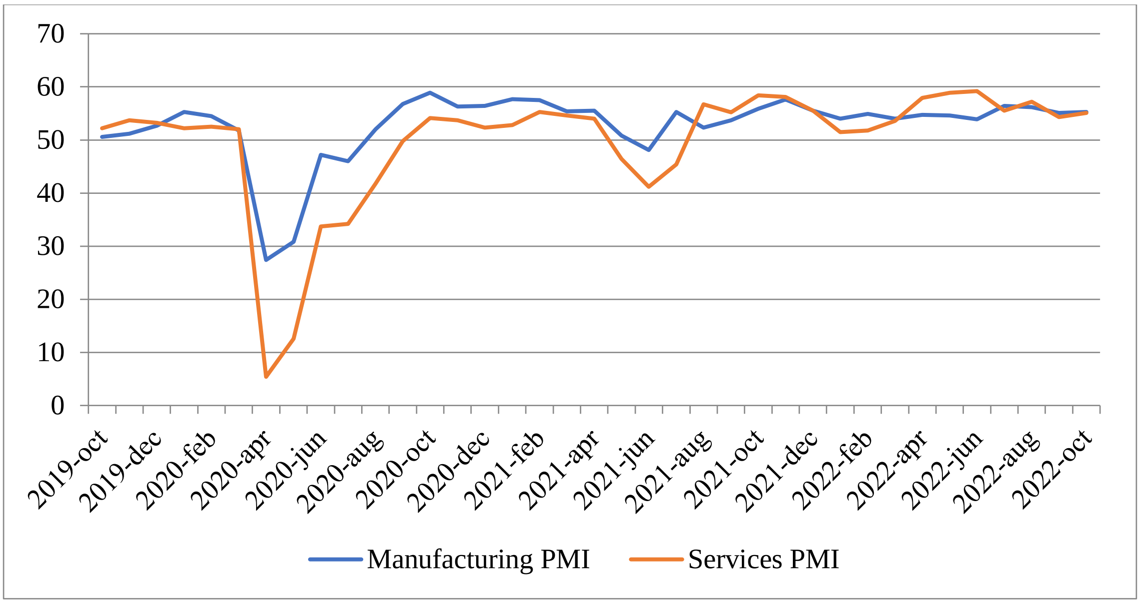
Country/region	GDP growth rate		
	2021	2022*	2023*
ASEAN5	3.4	5.3	4.9
Australia	4.9	3.8	1.9
Brazil	4.6	2.8	1.0
Canada	4.5	3.3	1.5
China	8.1	3.2	4.4
France	6.8	2.5	0.7
Germany	2.6	1.5	-0.3
India	8.7	6.8	6.1
Italy	6.6	3.2	-0.2
Japan	1.7	1.7	1.6
Mexico	4.8	2.1	1.2
Russia	4.7	-3.4	-2.3
Saudi Arabia	3.2	7.6	3.7
South Africa	4.9	2.1	1.1
South Korea	4.1	2.6	2.0
UK	7.4	3.6	0.3
US	5.7	1.6	1.0
World	6.0	3.2	2.7

Source: IMF World Economic Outlook, October 2022
Note: *projected growth rate

India's growth momentum is also reflected by its high-frequency indicators. Total Goods and Services Tax (GST) collection in the last six months (May-Oct 2022-23) was not only about 31 percent more than that in 2021-22 but also around 49 percent higher than that in the pre-Covid year 2019-20.[3] The purchasing managers' index (PMI) also indicates growth resilience. As Figure 1 shows, both manufacturing and services PMIs in recent months have not only remained substantially above the pandemic levels, but also in a higher range compared to that during the pre-pandemic times. In fact, both indicators have remained in expansionary mode for the last 14 months.

[3] GST Council, 2022

Figure 1: India's Manufacturing PMI and Services PMI, Sept 2019 to Sept 2022

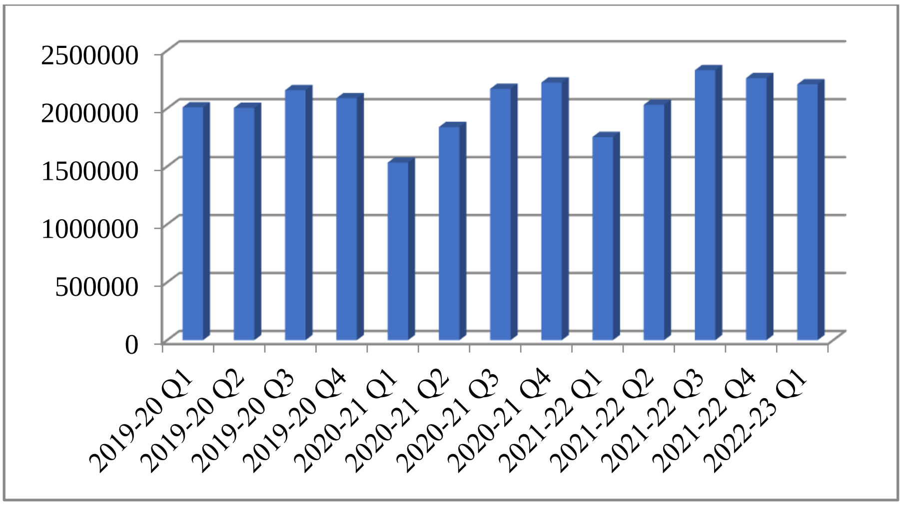


Source: Compiled from various media reports

Other key high-frequency indicators also show a rebound in growth momentum. For instance, during the last eight months (Jan-Aug 2022) merchandise imports witnessed a growth of over 40 percent compared to that in 2021. The unemployment rate that peaked in April 2020 to reach 23.5 percent has been hovering between 6-8 percent during the last one year, which is very close to the pre-Covid levels. Similarly, demand for work under the government-funded employment scheme MNREGA has been declining in recent months, demonstrating the availability of gainful employment opportunities in the economy.

Two vital factors that have been driving India's growth at present and are likely to sustain in the near to medium term are the return of private demand and rebound in investment. India's current growth momentum is largely due to private consumption, which constitutes about 55-60 percent of GDP. As Figure 2 illustrates, during the last few quarters, India's private final consumption expenditure (PFCE) has consistently remained above the pre-Covid level, indicating a full revival in private consumption. The level of PFCE in Q1 2022-23 was not only about 26 percent higher than the level in Q1 2021-22 but also approximately 10 percent higher than the pre-pandemic level in Q1 2019-20.

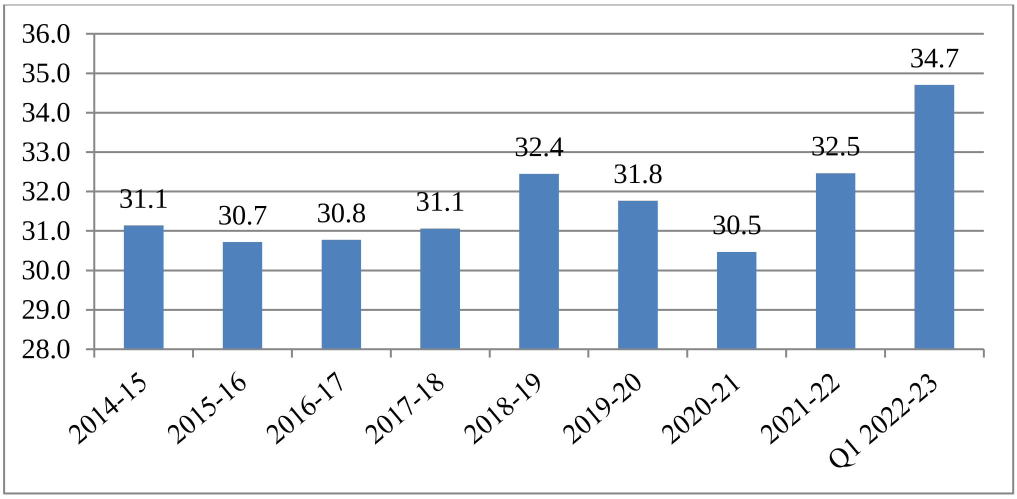
Figure 2: Private Final Consumption Expenditure, in Rs Crore



Source: Ministry of Statistics and Programme Implementation (MOSPI), Government of India

While private consumption plays a critical role in accelerating economic activities in the short run, an increase in capital expenditure is important for propelling growth in the medium to long-term. Owing to the substantial increase in capital expenditure by the government, there has been a sharp rebound in gross fixed capital formation (GFCF), which has pushed the GFCF rate to one of the highest levels in recent years (see Figure 3). The government's budgeted capital expenditure for 2022-23 has been increased by 24.5 percent over the revised figure for 2021-22. There are also signs of revival in private capital expenditure (CAPEX) in 2022, which is likely to remain elevated in 2023 and 2024 and further contribute to the growth momentum.[4]

Figure 3: Gross Fixed Capital Formation, as % of GDP



Source: MOSPI

[4] The Times of India, October 6, 2022

India's resilient growth has been supported by numerous policy measures introduced in recent years. The government has carried out several big-ticket reforms that have been the most desired, but long pending. The implementation of GST in 2017 is one such reform that India had waited for more than a decade. The GST has transformed India into a single market, apart from rationalising the tax structure. Another major reform is a big cut in the corporate tax rate to 17 percent for new manufacturing firms that have put India on par with several competitor economies, especially from South and East Asia regions, and significantly enhanced its attractiveness for foreign investment. India has further liberalised its foreign direct investment (FDI) regime. The FDI cap for the defence sector has been increased to 74 percent through an automatic route and up to 100 percent through a government route. Similarly, the FDI limit in the insurance sector has been increased to 74 percent. In the petroleum, natural gas, and telecom service sectors, the FDI cap has been increased to 100 percent.

Another major structural reform undertaken in recent years is related to labour laws, which has been pending for decades. India's labour regulations are known for their complexity and unfriendly nature to the industry. Most governments in the past avoided this grossly desired reform, mainly because of its perceived political ramifications. In the last few years, however, the government has made serious attempts to rationalise by clubbing 29 disparate and sometimes contradictory labour laws into four codes, making them less complicated to implement with reduced cost of compliance. Implementation of the Insolvency and Bankruptcy Code in 2016 was another key reform that made bankruptcy proceedings a time-bound process. Direct benefit transfer (DBT) is also a key reform measure that has led to the plugging of leakages in social programs and a significant reduction in delivery costs.

In recent years, the government has also introduced several other reforms that have contributed to India's economic growth. Some noteworthy measures include launching an online system for the application of green clearances for development projects, introducing standard guidelines for conducting environmental impact studies, establishing a National Asset Reconstruction Company of India Ltd. as a bad bank, expanding the definition of MSMEs, and focusing on digitalisation.

In addition, the government has introduced the following key schemes to augment the growth of the Indian economy, particularly in the manufacturing sector:

- *Make in India* is an overarching scheme to facilitate investment, foster innovation, and create world-class infrastructure to make India a hub for manufacturing, design, and innovation. Various steps under this initiative have led to significant improvements in the ease of doing business in the country.
- *Production Linked Incentive (PLI)* scheme provides incentives to 14 key sectors with surging demand and aims to enhance economies of scale and domestic capacity, and integrate India's manufacturers with global value chains (GVCs).
- *PM Gati Shakti* is an ambitious scheme that enables integrated planning and implementation of infrastructure connectivity projects across the country.
- *National Single Window System* integrates the existing clearance systems of various Ministries/Departments of Government of India and various State Governments.
- *Industrial Corridor Projects* aim to provide multi modal connectivity with complete "plug and play" infrastructure.

- *Start-up India* aims to aid young businesses. This has led to a significant expansion of the country's startup sector.
- *India Industrial Land Bank* is to help investors identify their preferred location for investment.

It is important to note that India's economic growth in recent decades has been largely driven by the service sector. While the share of services in GDP has increased, the contribution of manufacturing has stagnated, which has been a major concern for Indian policymakers. Therefore, one of the major objectives of all major policy initiatives, especially during the last decade, has been to enhance the share of manufacturing in the country's GDP. To realise this objective, the government has been working mainly on two fronts: massive investment in infrastructure and the creation of a conducive environment through various reform measures and schemes. These policy initiatives have contributed to and facilitated India's growth and offer immense opportunities for East Asia Summit countries in many sectors, such as infrastructure and several manufacturing industries.

Infrastructure is at the core of government priorities. In 2022-23, the budgetary expenditure of three key infrastructure ministries–Communications, Road Transport and Highways, and Railways–grew by 93 percent, 52 percent and 17p percent, respectively from 2021-22.[5] It is estimated that India needs to spend about US$ 1.4 trillion on infrastructure in order to realise its aim of becoming a US$ 5 trillion economy by 2024-25.[6] Keeping this objective in mind, the national infrastructure pipeline (NIP) has been launched with a projected investment of approximately US$1.5 trillion during 2020-25. The NIP places strong emphasis on attracting both domestic and foreign investments in the infrastructure sector.

Some of the key manufacturing industries that have enormous growth potential and are likely to offer great opportunities to East Asia Summit economies are as follows.

Electronics manufacturing: Driven largely by rapidly increasing domestic demand, electronics manufacturing is one of the fastest growing sectors in India. The value of electronics manufacturing has more than doubled from US$ 37.1 billion in 2015-16 to US$ 75 billion in 2019-20. The exports have also increased from US$ 5.7 billion to US$ 11.2 billion during the same period.[7] However, the government envisages transforming India into a US $ 300 billion global hub for electronics manufacturing by 2025-26. The government has introduced several policy initiatives, including PLI for large-scale electronics manufacturing and IT hardware, schemes for manufacturing electronic components and semiconductors, and modified electronics manufacturing clusters 2.0 etc. The sector has recently attracted investments from several global players, such as Apple and Foxconn.

Auto-component industry: The auto-component industry is another industry with high potential. Before witnessing de-growth in FY2020 and FY2021, the auto-component industry experienced robust expansion at a Compound Annual Growth Rate (CAGR) of approximately 10 percent from FY2014 to FY2019. The industry bounced back in FY2022 with an annual growth of 23 percent over FY2021. Given that domestic vehicle sales have experienced a significant surge in recent months, and economic prosperity is spreading beyond big urban clusters, the auto-component industry is likely to continue its growth momentum in the near to long-term future.

[5] Ministry of Finance, 2022a
[6] Ministry of Finance, 2022b
[7] India Cellular and Electronics Association, 2022

Pharmaceutical industry: The pharmaceutical industry is one of the most thriving industries in India. India's pharmaceutical industry is the world's 3rd largest in terms of production. Owing to its cost competitiveness, exports constitute approximately half of the total revenue of the industry. This industry has grown at a CAGR of 9.43 percent over the last nine years.[8] The industry is estimated to grow at a CAGR of 12 per cent during 2020-30 and its revenue will likely increase from US$ 42 billion to US$ 130 billion during the same period.[9] The government has put in place a number of schemes to augment the growth of the pharmaceutical industry, including the PLI and Scheme for Promotion of Bulk Drug Parks, to create world-class infrastructure for the bulk drug industry.

Defence sector: With a total expenditure of US$ 76.6 billion in 2021 India was the third largest military spender on the planet.[10] However, India has largely been dependent on imports for its defence equipment that too on suppliers from a very few countries. With import value of US$ 15.4 billion in 2017-21 India was the world's largest importer of arms.[11] However, in recent years, intensive efforts have been made by the government to expand domestic manufacturing capacity. Several steps, such as liberalisation of the FDI regime, development of dedicated defence industrial corridors, and innovation-enabling initiatives, such as Innovations for Defence Excellence and Defence Testing Infrastructure Schemes, have been taken to strengthen domestic manufacturing. These developments offer opportunities for new players from East Asia Summit countries, particularly through joint ventures with local companies.

Food processing industry: With India transitioning from food scarcity to surplus food production, opportunities for food processing have increased significantly. Food processing is one of the fastest growing sectors of the economy and has grown at 11.2 percent during the last five years ending 2019-20[12] and is likely to grow at a CAGR of 10 percent during 2022-27[13]. The market size is estimated to increase from US$ 309 billion in 2021 to US$ 566 billion by 2027. The key factors driving the expansion of Indian food processing industry include e-retailing, the rise of health-conscious consumers, the growing working women population, and the rising demand for processed food. The government has undertaken several initiatives, such as allowing 100 percent FDI, PLI, development of food processing supply chain, One District One Product (ODOP) scheme, and lower GST to augment the growth of the sector.

Although India is likely to remain one of the fastest growing economies in the world, it faces several challenges that could affect its growth prospects. The slowdown in the global economy and the resultant decline in export demand will enhance India's challenge of maintaining a higher growth rate. The second important issue is inflation, which is mainly caused by supply chain disruptions and volatility in energy prices. Domestically, although the current government has been able to undertake several bold reforms, it is difficult to bring reforms in the electricity and agriculture sectors, thereby affecting the country's growth potential. Despite these limitations, however, several fundamental factors, such as an increasing appetite for economic prosperity beyond urban areas, abundance of working-age

[8] India Brand Equity Foundation, 2022
[9] Ibid
[10] SIPRI, 2022a
[11] SIPRI, 2022b
[12] Ministry of Finance, Government of India, 2022b
[13] Imarc, 2022

population, strong faith in digital technology, political stability with democracy, and growth-enhancing policy changes are likely to pull India’s growth to a relatively higher pedestal.

Overall, despite global headwinds and some domestic challenges, India is likely to remain one of the fastest growing large economies globally and offers great opportunity to the rest of the world in general and East Asia Summit countries in particular.

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