

# Economic Outlook and Policy Challenges<sup>1</sup>

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## Abstract

Against the backdrop of robust macro-economic stability, the year was marked by two major domestic policy developments, the passage of the Constitutional amendment, paving the way for implementing the transformational Goods and Services Tax (GST), and the action to demonetise the two highest denomination notes. The GST will create a common Indian market, improve tax compliance and governance, and boost investment and growth; it is also a bold new experiment in the governance of India's cooperative federalism. Demonetisation has had short-term costs but holds the potential for longterm benefits. Follow-up actions to minimize the costs and maximise the benefits include: fast, demand-driven, remonetisation; further tax reforms, including bringing land and real estate into the GST, reducing tax rates and stamp duties; and acting to allay anxieties about over-zealous tax administration. These actions would allow growth to return to trend in 2017-18, following a temporary decline in 2016-17.

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## I. Introduction

THE ECONOMIC SURVEY of 2014-15 spoke about the sweet spot for the Indian economy that could launch India onto a trajectory of sustained growth of 8-10 percent. Last year's Survey assessed that "for now, but not indefinitely, that sweet spot is still beckoningly there." This year's stocktaking suggests that shifts in the underlying vision will be needed to overcome the major challenges ahead, thereby accelerating growth, expanding employment opportunities, and achieving social justice (Chapter 2 in this Survey). In the aftermath of demonetisation, and because cyclical developments will make economic management harder, articulating and embracing those shifts will be critical to ensuring that that sweet spot is enduring not evanescent.

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will help Bihar converge, while already rich Haryana and Maharashtra will pull further away from the average level of income per capita in India. On the other hand, Kerala, Madhya Pradesh, Chhatisgarh, and West Bengal are negative outliers: their future dividend is relatively low for their level of income. This will make the poorer states fall back, unless offset by robust reforms and growth, while the relatively rich Kerala will probably converge to the average as its growth momentum declines rapidly.

The growth boost from the demographic dividend is likely to peak within the next five years, as India's share of working age population plateaus. However, India may not see the sharp growth decelerations experienced by the East Asian countries because its working age ratio will fall much more gradually than those in other countries. In addition, the sharp demographic differences between peninsular India and hinterland India will generate wide differences in the timing of the peak, as well as opportunities to attenuate demographic imbalances via greater labour mobility (See Chapter XII of Economic Survey 2017). Even so, the urgency of reforms to maximise this soon-to-recede dividend cannot be overstated.

### Notes

1. Strictly speaking, these notes were deprived of their legal tender status, except for specified activities (such as paying utility bills). Nevertheless, "demonetisation" has entered the public lexicon as the term for the November 8 announcement.
2. <http://krugman.blogs.nytimes.com/2015/09/17/fear-the-rating-agencies/>
3. Though capital goods is a major exception.
4. In normal times, nominal GDP growth would not be of particular policy interest. But at a time when the GDP deflator has been subject to unusual measurement uncertainty, nominal growth conveys additional information about real activity.
5. The headline numbers are based on taking out all the demonetised notes and adding the new notes. The *Survey's* estimates take account of other factors (detailed in Chapter 3).
6. Weak credit growth was offset to a small extent by increase in other forms of private sector borrowing such as bonds, External Commercial Borrowings (ECBs), and commercial paper.
7. The quarterly data on real estate prices is on a calendar year basis.
8. Paul Warde (2007), *Energy Consumption in England and Wales: 1500-2000* published by Consiglio Nazionale delle Ricerche (CNR), Istituto di Studi sulle Società del Mediterraneo (ISSM)
9. Source: Swachh Bharat Mission website: <http://www.sbm.gov.in> (accessed on January 21, 2016)
10. Swachhata Status Report, National Sample Survey Organisation, 2016
11. The differences between Census-2011 and more recent data sources are in large part due to the rapid acceleration of toilet provision under the Swachh Bharat Mission
12. The Rapid Survey on Gender Norms and Sanitation and Hygiene, and Implications by life-stage (adolescent girls, pregnant women, and mothers of children under 5), covered 10 states with different levels of sanitation coverage across 5 geographical zones.
13. All proportions cited in this section are conditional means after controlling for other confounding factors including caste, religion, Above Poverty Level or Below Poverty Level status, rural/urban, gender, and Individual Household Latrine (IHHL) availability. All numbers cited are statistically significant at 95% confidence interval.
14. The rapid survey captured long distances as the respondent's self-reported variable.
15. New demographic projections for the states from 2011-2051, based on the latest fertility and mortality indicators, have been done by Professor S Irudaya Rajan and Dr S Sunitha at the Center for Development Studies, Kerala.

16. It is assumed that every state earns the same growth dividend from an increase in the WA/NWA ratio as the all-India average. This is a critical assumption, and one that may not be true, since the actual dividend will depend on the governance, the policy framework in place at the state level, and also on internal migration between states.

**Annexure I**  
**Currency weights for alternative Exchange Rate Indexes**

	IMF 25 Countries	RBI 36 Countries	Asia-H 36 Countries	Asia-M 36 Countries
1 United States	17.82	8.80	7.86	11.44
2 China	12.47	10.84	43.51	31.12
3 Germany	9.08		3.36	5.04
4 Japan	6.13	2.72	2.10	3.15
5 United Kingdom	5.58	2.36	2.60	3.52
6 France	4.63		1.61	1.96
7 Belgium	4.53		2.64	3.95
8 Italy	4.33		1.39	2.09
9 Korea,	4.26	2.65	2.26	3.39
10 Singapore	3.53	3.37	2.30	3.45
11 United Arab Emirates	2.84	11.44		
12 Australia	2.47	2.36		
13 Netherlands	2.39		0.94	1.41
14 Canada	2.20	0.69		
15 Spain	2.12			
16 Taiwan	1.96	1.18	0.83	1.24
17 Malaysia	1.90	2.07	1.12	1.68
18 Russian Federation	1.85	0.97	1.12	1.46
19 Thailand	1.70	1.28	1.18	1.77
20 Indonesia	1.51	3.02	0.71	1.06
21 Switzerland	1.42	4.80	0.70	0.94
22 Brazil	1.41	1.51		
23 Sweden	1.34	0.40		
24 Israe	1.28	0.95	0.77	1.16
25 Turkey	1.26	0.69	0.96	1.01
26 Saudi Arabia		5.51	1.93	1.94
27 Hong Kong		3.41	4.01	5.63
28 Kuwait		2.52		
29 Nigeria		2.49		
30 Iran		2.38	0.55	0.82
31 South Africa		2.08	0.57	0.86
32 Qatar		1.89		
33 Vietnam		0.81	5.80	3.36
34 Egypt		0.75		
35 Sri Lanka		0.74	0.56	0.85
36 Bangladesh		0.73	1.21	1.09
37 Mexico		0.58	4.45	2.57
38 Kenya			0.45	
39 Pakistan			0.36	
40 Argentina			0.25	
41 Philippines		0.24	1.36	0.88
42 Poland			0.90	0.64
43 Czech Republic			0.71	0.51
Euro Area	27.08	12.69	11.56	15.62
Total weight	100.01	99.98	100.00	100.00
Top 20 currencies	93.30	88.91	92.76	91.33

ASIA-H (ASIA-M) refers to the notional basket where Asian countries are given considerably (moderately) more weight than the other 2 indices. The top 3 currencies under each of the weighting schemes are shown in bold.

How are these weights determined? For each trading partner, we take two weights: the first is based on its actual share in India's manufacturing imports (say W1); the second is computed by focusing on those countries that have increased their global manufacturing export share between 2010 and 2015 based on UNCTAD data. For each such country, we calculate the ratio of its increase to the sum of the increase of all countries (W2). So, for example, if ten countries increased their collective share by say 10 percentage points, including a 4 percentage point increase by China, China's share will be 0.4, and similarly for other countries. In ASIA-H, we assign equal weights to W1 and W2. In ASIA-M, we assign weights of 0.75 and 0.25, respectively for W1 and W2.

## Annexure II Details of Survey on Sanitation

**Sample Size:** The sample used for the rapid study consisted of respondent categories spread across lifecycle:

- i. adolescent girls (10-19 years of age);
- ii. pregnant women;
- iii. women with children of age 0-60 (completed) months.

Men from a sub-sample of households were also covered under the study for a comparative insight.

For this purpose, the country was divided into 5 geographic zones- Highest IHHL coverage, High IHHL coverage, Medium IHHL coverage, Low IHHL coverage and Lowest IHHL coverage and 2 states were selected from each zone (1 low performing and 1 high performing state with respect to IHHL construction). Two districts each from the states, 12 PSUs from each district and 18 households from each PSUs resulted in a sample frame of 4320 households, with 5705 individuals (4255 women and 1450 men).

State and districts were selected based on IHHL coverage. One High performing and one low performing state was selected from each zone Similarly one high performing and one low performing district was selected from each state. Also, sample of 18 respondents was randomly selected from the sampling frame, equally divided among the three respondent categories. A limitation of this study is that it is not a nationally representative sample.