Reforms: Road to Investment, Employment and Growth

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The economic policy of the government in its first year has been focused on reforms, infrastructure, ease of doing business to revive investment for manufacturing sector growth for job creation and improvement in standard of living. Though it's too early to measure outcomes of these policies, the future of Indian economy certainly looks bright

HIGH INFLATION, dwindling growth, low investor's confidence, and policy paralysis in many areas in last few years before the General Election in 2014 resulted in high expectations from the Indian Industry, investors and the people at large from the new government. Everybody looked up to the new government to ease their pain and bring back the economy on track. It has taken several important steps to revive domestic investment, ensure ease of doing business, attract foreign investors so as to enable **'Make in India'** initiative a successful one for manufacturing-led job creation and growth. Undoubtedly, it has been a year of good governance, and growth and development that has taken place is significant, however, the dreams of a billion of people are yet to be fulfilled. The following have been the policy focus areas and achievements.

Ease of Doing Business

The government has taken many steps to ease doing business in India. Investments worth Rs 16 lakh crore were stalled when the present Government won a thumping majority to lead the country. Policy paralysis and retrograde taxation policies in the previous years had put off investors. The present government has addressed most of these through new legislations, changes to old laws, new notifications as well as through budget provisions. It cannot be claimed that any dramatic uptick in investment activity has occurred although the rate of capital formation has increased by 4.1 per cent in FY 2014-15, as per the government estimates. Specific policies to ease of doing business include deciding not to pursue the tax dispute with a leading telecom firm and announcing the end to the imposition of retrospective taxation in the 2014 interim budget.

Doing business in India is not easy as reflected by India's rank of 142 among a total of 160 countries as mentioned in the Global Competitive Index 2014. The Budget 2015-16 proposed many measures to ease doing business in India (Sahoo, 2014a; 2014b). A few of them include, setting up of an expert committee to get rid of multiple prior permissions, commitment to Goods and Services Tax (GST), abolishing wealth tax, reducing corporate tax rates from the present 30 per cent to 25 per cent over the next four years, an e-business portal which merges 14 regulatory permissions at one place, proposal to bring bankruptcy law for easier exit of investors, proposal to bring public contracts bill for dispute resolutions, deferring general anti-avoidance rule by two more years, dedicated branches in courts for early resolutions of commercial disputes are all measures directed towards improving the business environment.

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Commitment to implement GST from 1st April 2016 and phasing out of tax exemptions and concessions to corporates, which leads to innumerable tax disputes, are meant to be put in place for a transparent and more rationalized tax structure. Further, getting rid of distinction between foreign direct Investment and foreign portfolio investment, and merging Forward Markets Commission with Security and Exchange Board of India for market regulations are meant to reduce multiplicity in administration and regulations and bring transparency in doing business. All these steps are directed towards reducing red-tapism, procedural delays, improving enforcement of contracts and facilitate quick dispute resolutions.

The Finance Minister also renewed is commitment towards enactment of the Goods and Services Tax (GST) Bill which is heralded as a landmark business-friendly reform. The GST requires Constitutional Amendment by both the Houses as well as by a majority of all State assemblies. The government demonstrated its commitment to the cause by periodically addressing state's concern, handing out olive branches to stubborn opposition parties, and eventually getting states and opposition parties on board. The GST Bill, with some amendments, was passed by the Lok Sabha on 6 May 2015. The Bill seeks to put in place a uniform, comprehensive tax on manufacture, sale and consumption of goods and services. The GST will subsume a range of indirect taxes currently levelled at the Centre and State levels. These include excise, service tax, sales tax, VAT, entry tax, luxury and entertainment taxes and cesses and surcharges relating to goods and services. The GST will also enable better tax compliance and possible widening of the tax base. It would also plug existing loopholes that emerge out of a multiplicity of taxes leading to unwanted litigations. The government estimates 1 to 2 per cent growth in GDP as a result of the implementation of GST. As of now, amendments include compensation to states for a period of five years, an additional 1 per cent tax on interstate goods transport, and the exclusion of alcohol from its ambit, with the GST on petroleum products deferred for now.

Much of the procedural and administrative hurdles that businesses face in India have also been tackled, or are set to be tackled (Sahoo, 2014b). Many of these pertain to the complexity and multiplicity of paperwork, as that is one of the major causes of red-tape in India. The launch of eBiz portal for businesses is one of the technology enabled e-governance efforts. The eBiz portal is a single-window system on the web for firms to navigate the documentation-related formalities of setting and managing a business in India. As of now, eleven services can be availed online on G2B eBiz portal. The government aims to integrate 26 central government services across nine departments on the platform.

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The reduction in the number of documents required to import and export goods to and from India has been reduced to three from ten, thus substantially cutting transaction costs – one of the banes relating to trade in India. Security clearances for foreign investment promotion board (FIPB) investment proposals will now be cleared by 30 days, down from 90 days earlier. The states also have been pitching in. For example, the time required for a new electricity connection in Maharashtra has been reduced from 67 days to 21 days while the number of procedures involved in the same has been cut down to 3 from the existing 7.

In terms of the broader governance architecture, the government has sought to streamline the regulatory regime by merging implementing authorities (for example, the proposed merger between Forward Markets Commission (FMC) and Security and Exchange Board of India (SEBI), combining multiple and overlapping laws (for example the proposed five pronged labour code to replace the 44 laws governing labour relations now). These will help in better compliance, while contributing significantly to the ease of doing business in the country. The much awaited labour reforms necessary for mass manufacturing in India have finally been initiated last year. Any efforts to rationalise labour rules, around 250 together both at the Central and State Level, is a welcome step for the industry. The two key areas of reforms announced are namely 'unified labour and industrial portal' and 'Labour Inspection Scheme'. The objective criteria and transparent process for labour inspection would be a breather for industry, more so for SMEs, which are allegedly victims of arbitrary use of labour rules by labour inspectors. Introduction of Labour Identification Number (LIN) and putting inspection on unified portal will go a long way in bringing transparency in use of labour rules. Prime minister's efforts to raise minimum wage ceiling from Rs 6500 to Rs 15, 000 and to ensure EPF for vulnerable groups and pension system, though meagre, are laudable steps.

To undo the malady in India's labour market, some changes have recently been initiated in the three acts that largely govern India's labour market: Factories Act (1948), Labour Laws Act (1988) and the Apprenticeship Act (1961). Amendments to some restrictive provisions of all these acts have been cleared by the Cabinet. In order to provide flexibility to managers and employers, the amendment to the Factories Act includes doubling the provision of overtime from 50 hours a quarter to 100 hours in some cases and from 75 hours to 125 hours in others involving works of public interest. This is seen by some as being anti-labour as it imposes greater working hours without ensuring their security and welfare. However, the penalty for violating the Act has been increased so as to deter exploitation. Increasing the working hours might also have to do with low worker productivity in India which requires the devotion of more hours for a given task. However, even as productivity issues should be addressed in part by bringing in quality FDI, it is important that maximum-hour protection is strictly enforced so as to prevent worker exploitation. In further relaxation, norms of female participation in certain industry segments have been relaxed (this is helpful in the Indian context). Importantly, the number of days that an employee needs to work before becoming eligible for benefits like leave with pay has been reduced to 90 from 240, a pro-labour step (Sahoo, 2014b; 2014d).

The amendments to Labour Laws Act 1988 meanwhile will allow companies to hire more employees without having to fulfil weighty labour law requirements as it is proposed that companies with 10-40 employees will now be exempt from provisions under labour laws that mandates them to furnish and file returns on various aspects. This is a crucial step and will help keep off unnecessary procedural delays, an inordinate feature of doing business in India.

Infrastructure, Manufacturing and Investment

Boosting the manufacturing sector is an imperative for the Indian economy. Around 1 million people enter the workforce every month and unemployment hovered around 3.7 per cent in 2013. At the same time, educational levels and general skills are short in supply. As a result, low skilled manufacturing jobs have the highest chance of abating underemployment and unemployment. However, the contribution of the manufacturing sector has languished at about 15 per cent of GDP for years. The government has rightly identified the problem and focused on the manufacturing sector on a mission mode. The government's 'Make in India' scheme basically announces to the world that India is a better place to invest in than before, that the government is doing what it can to ease the rules and simplify procedures, while investing in physical infrastructure. With the aim of making India a production hub for global manufacturing companies, the government has promoted the scheme extensively within and outside India. The focus sectors include mining, telecom, textiles, automobiles, biotechnology, chemicals, construction, defence, food processing, leather, pharmaceuticals, and railways. As on February, the government had received project proposals worth Rs 21,000 crore under the scheme of which Rs 6000 worth of projects have been sanctioned.

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Further, the government has put more focus on ease of doing business and a boost in physical infrastructure. Since taking office, the government has made elaborate plans to spend on infrastructure, mainly focusing on connectivity. As a result, the government has made it a point to provide timely environmental clearances for projects.

In terms of ideational changes, the government mooted taking on greater responsibility in PPP models, because some of the PPP projects were getting stuck or quickly becoming Non Performing Assets. This is because the private sector didn't manage to shoulder multifarious implementation risks while navigating the policy scenario. The economic survey said that the stock of stalled projects at the end of December 2014 stood at Rs.8.8 trillion, or 7 per cent of gross domestic product (GDP).

In the interim budget, the government's allocation to infrastructure increased 8.6 per cent, from Rs 1,66,756 crore in 2013-14 to Rs 1,81,134 crore. The projects would span power, coal, roads, civil aviation, ports and railways sectors. The budget 2014-15 focused on infrastructure (roads/highways through NHAI, building and improving ports, smart cities, airports), InvIT (infrastructure investment trusts), an investment instrument, has been provided with tax incentives, thus dealing with the issue of funding of infrastructure. The interim budget 2014-15 allotted almost Rs 38,000 crore for national highway development and another Rs 14,389 crore for development of roads under the 'Pradhan Mantri Sadak' Yojana. The focus was to interconnect cities and achieve the quality road network of 8,500 km NH construction, which is the key medium of transportation in India. Further, Rs 7,060 crore for development of 100 smart cities and new airports through PPP; Rs11,000 crores allocated for the setting up of 16 new ports; Rs. 4,200 ensure EPF for vulnerable groups and pension system, though meagre, are laudable steps.

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Micro Small and Medium Enterprises (MSMEs) form the backbone of India's manufacturing sector. Such small enterprises account for 40 per cent of manufacturing output and 40 per cent of exports. Their share of manufacturing employment is also high. Estimates suggest that just about 10 per cent of MSMEs have access to institutional finance. Thus, the emphasis on credit delivery through market instruments makes sense since the banking sector hasn't been up to the task so far, despite the sector being under the RBI's priority sector. The proposal to set up a Microfinance Unit Development Refinance (MUDRA) bank to refinance microcredit will make credit affordable while helping the micro finance industry retain sound financials. With an initial corpus of Rs 20,000 crore and a credit guarantee corpus of INR 3000 crore, the MUDRA bank, it is suggested, should prioritise lending to Scheduled Castes and Scheduled Tribes.

A number of measures to have been taken revive Special Economic Zones (SEZs), attract FDI and pursue reforms in important sectors like defence to success in 'Make in India" story. The Budget 2015-16 has taken effective steps to revive SEZs including giving investment allowance at 15 per cent for 3 years to a manufacturing company which invests more than Rs. 25 crore in plant and machinery; announcing special SEZ's for women in 100 districts etc.

The huge increase in untied resources would give states the fiscal space to design their own developmental schemes and programs according to their specific circumstances. However, there is also apprehension about the use of money by the States as the quality and capacity of state administration varies widely and therefore, the increased untied fiscal transfers along with reduction in tied developmental plan schemes may lead to misuse of money.

The government's agenda to skill India and improve employability of young Indians is quite clear by creating institutes of higher learning, including five new IITs and five new IIMs across the country. The government focuses on creating industrial tier II and tier III cities and skill development for job creation and manufacturing development. Further, a few other steps like 10,000 crore start-up fund for new businesses, Rs. 100 Crore for start-up village entrepreneurship for rural population, Rs. 200 Crore for scheduled caste entrepreneurs and Young Leaders Programme with an investment of INR 100 crore are encouraging steps.

The hike in FDI caps in insurance and defence sectors to 49 per cent, almost scrapping of retrospective taxes, raising FDI limits in e-commerce, insurance, defence, and health insurance is one sign that the government is headed the reform way to attract FDI, which is necessary for manufacturing-led growth for job creation. In defence, the Commerce and Industry ministry in consultation with defence ministry (MoD) has already circulated a cabinet note seeking comments from other government agencies. It is a welcome move to increase FDI ceiling in defence in graded steps to 49 per cent, 74 per cent and 100 per cent to incentivise technology transfer. FDI up to 49 per cent in case of no technology transfer and 74 per cent where there is a technology transfer is being proposed and a no-cap policy for cases which bring in state-of-the-art technology. This would help India in leveraging critical technologies to shore up domestic capability in Indian defence industry and thereby creating jobs in the country, by setting up of JVs.

Fiscal Decentralisation and Cooperative Federalism

The recommendations of the 14th Finance Commission (FC) have come at a time when the new regime is committed to cooperative and competitive federalism. The current government accepted the recommendations of the Fourteenth Finance commission and ushered in a new era of fiscal federalism in the country. The share of the 'divisible pool' — the basket of tax revenue that is allocated between the federal and state governments —goes to states without any strings attached from the 32 per cent to 42 per cent. Together with grants to local bodies, grants in aid for revenue deficits for 11 states and the states' share in coal auctions means that there will be huge increases in fiscal transfers to states. This would reduce the fiscal capacity of the Centre, discouraging it from getting involved in states' affairs. The huge increase in untied resources would give states the fiscal space to design their own developmental schemes and programs according to their specific circumstances. However, there is also the apprehension about the use of money by the States as the quality and capacity of state administration varies widely across States and therefore, the increased untied fiscal transfers along with reduction in tied developmental plan schemes may lead to misuse of money.

The 2014-15 too in fact, ushered in greater fiscal autonomy to states through an act of change in the structure of outlays. In fiscal year 2013-14, states got Rs 1,19,039 crore out of the Rs 4,75,532 crore plan outlays. In the 2014-15 Budget, states were allocated Rs 3,38,408 crore from the total plan kitty of Rs 5,75,000 crore, equalling additional resources worth nearly 1.6 per cent of GDP that have been shifted from centre to states. The commitment to cooperative and competitive federalism is also evinced by the fact that the Centre has left implementation of many crucial laws including in labour and land to the individual states. Well-governed states with proper institutions and vision are now likely to prosper on account of the increased fund disbursal.

Over all, the economic policy of the government in its first year has been focused on reforms, infrastructure, ease of doing business to revive investment for manufacturing sector growth for job creation and improvement in standard of living. Though it's too early to measure outcomes of these policies, the future of Indian economy certainly looks bright.

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