INVESTMENT DRIVEN ECONOMY

The Prime Minister has set out a clear vision for a $5 trillion economy by 2024-25, a nominal GDP of Rs. 375 lakh crore. In turn, this requires sustaining a real GDP growth rate of 8% a year. What are the ingredients of a model that can generate such growth?

The overwhelming evidence, especially from East Asia, is that such high growth rates have only been sustained by an economic model driven by a virtuous cycle of savings, investment and exports supported by a favourable demographic phase. As discussed in the latest Economic Survey, India has already entered a period with a high share of working-age population, and will remain in this 'demographic dividend' phase for over two decades. However, favourable demographics is not sufficient.

Broth for Growth

Cross-country data shows that sustained high growth has always been driven by investment. Indeed, a GDP growth rate of 8% will typically require an investment effort in excess of 35% of GDP. Investment, especially private investment, is the 'attractor' that drives demand, creates capacity, increases productivity, introduces new technology, allows creative destruction and generation jobs.

East Asia is the most recent example of this investment-driven model. But western Europe did the same during post-World War 2 reconstruction, as did Britain in the 19th century. (London still relies heavily on Victorian infrastructure.)

Note that this is a departure from conventional economic thinking that tries to solve individual problems in silos. Instead, the Economic Survey argues for a virtuous cycle driven by a single key driver.

Importantly, international experience is that a high investment effort must be backed by domestic savings. Foreign investment can provide additional funds, technology and international value chain linkages. But bulk capital always comes from domestic savings. Foreign direct investment (FDI) seems to be complementary to domestic savings rather than a substitute. (This is an extension of the well-known Feldstein-Horioka puzzle.)

International data shows that savings are insensitive to real interest rates, except in extreme conditions. Instead, savings are driven by demographics and income growth. This means that when demographics is conducive, it is possible to trigger a virtuous cycle of savings-investment growth. Notice how the relative insensitivity of savings to interest rates provides a key degree of freedom that can be exploited to structurally lower cost of capital.

Investment-led growth has its own constraints. First, consumption cannot be the primary driver of demand, since it requires high domestic savings. So, who provides the final demand for the large capacities created by high investment? Exports. This is why an aggressive export strategy must be a part of any investment-driven growth model.

While it is true that world trade is currently facing some disruptions, India's share in global exports is so low that it should focus on market share. One could even argue that the current disruptions provide an opportunity for India to insert itself into global supply chains. The High Level Advisory Group, chaired by Surjit Bhalla, will shortly submit its report on how India can sharply increase exports.

Running the Cycle

Second, the investment-led growth model implies an expansion in the financial system by an order of magnitude – both banks and capital markets. In turn, this runs the risk that such a rapid expansion could be disrupted by a major financial crisis that derails the savings-investment dynamic. This is no idle concern as illustrated by the Asian Crisis of 1997-98.

Some Southeast Asian countries appeared to be recreating the East Asian miracle in the 1990s, but were unable to sustain the virtuous cycle because of large-scale misallocation of capital. India's recent effort to clean up the banks and establish a bankruptcy process should be seen as valuable investment in this context.

If India had attempted to press the accelerator five years ago, it would have almost certainly have been hit by a major financial crisis in a few years. Painful as it may have seemed, the banking sector clean-up and the introduction of the new bankruptcy framework are important foundations that will now prove valuable.

Economic Survey 2019 highlights many key reforms needed to trigger investment-driven growth, ranging from unshackling small and medium enterprises from the mindset of 'dwarfism', to the use of real-time data for feedback loops. Nevertheless, speeding up the legal system must be top priority, as contract enforcement is now arguably the single biggest issue constraining private investment.

It is commonly assumed that case pendency is a large, insolvable problem. But the Survey shows that 2,279 additional judges in lower courts and 93 in high courts would be enough to reach 100% care clearance rate (zero accumulation) at even current productivity levels. Moreover, the efficiency gains needed to clear the backlog within five years are large, but not unachievable. Improving the legal system is, perhaps, the best investment India can make.

TOWARDS A $5 TRILLION ECONOMY

In this year, marking the 150th birth anniversary of Mahatma Gandhi, we are at a crucial juncture in history with an immense opportunity to give shape to 'New India'. Economic Survey 2018-19 has, therefore, adopted the theme of realizing Prime Minister Narendra Modi's vision of a $5 trillion economy by 2024-25.

The Survey employs unfettered, 'blue sky' thinking to evolve an appropriate economic model for India, and also lays down a blueprint to enable a 'shifting of gears' through a virtuous cycle of growth, to sustain a real GDP growth rate of 8%. This endeavour is reflected in the sky blue cover of the Survey and the cover design depicting several inter-linked gears.

The Survey departs from traditional thinking by viewing the economy as being either in a virtuous or a vicious cycle, and thus never in equilibrium. Rather than viewing the national priorities of fostering economic growth, demand, exports and job creation as operating in 'silos', the Survey views these macroeconomic phenomena as complementary to each other. The cover design captures the idea of complementary inter-linkages between these macroeconomic variables.

International experience, especially from high-growth East Asian economies, suggests that sustained high rate of growth needs a catalytic virtuous cycle of savings, investment and exports supported by a favourable demographic phase. Investment, especially private investment,

is the key driver that drives demand, creates capacity, increases labour productivity, introduces new technology, allows creative destruction, and generates jobs. This is another departure from traditional economic thinking based on consumption-led economic growth.

After laying out this strategic blueprint for fulfilling the vision of #Economy@$5trillion, the Survey describes some the tactical devices required to navigate an uncertain world in constant disequilibrium. The Survey delineates the impact created by government's flagship initiatives such as Swachh Bharat Mission, Jan Dhan Yojana and *Beti Bachao Beti Padhao*, which provide testimony to the potential for behavioural change in India. Given our rich cultural and spiritual heritage, social norms play a very important role in shaping our behaviour.

Behavioural economics provides the necessary tools and principles to not only understand how norms affect behaviour but also to utilize these norms to effect behavioural change. The Survey, therefore, lays out an ambitious agenda for behavioural change by applying the principles of behavioural economics to several issues including gender equality, a healthy and beautiful India, savings, tax compliance and credit quality.

The Survey also focuses on nourishing MSMEs to create jobs and become more productive so that they can become internationally competitive. It suggests that all size based incentives must have a sunset clause of less than 10 years with necessary grand-fathering. Further, deregulating labour law restrictions can create significantly more jobs, as seen by the recent changes in Rajasthan when compared to the rest of the states.

Heading into a century where data has become the new oil and analytics from data the new tool for decision making, the Survey foresees countless opportunities in creating data as a public good 'of the people, for the people and by the people'. Governments already hold a rich repository of administrative, Survey, institutional and transactions data about citizens, but these data are scattered across numerous government bodies.

Utilizing the information embedded in these distinct datasets would, inter alia, enable government to enhance ease of living for citizens, enable truly evidence-based policy, improve targeting in welfare schemes, integrate fragmented markets, bring greater accountability in public services and generate greater citizen participation in governance.

The Survey recognizes that the single biggest constraint to ease of doing business in India is the ability to enforce contracts and resolve disputes. This is not surprising given the 3.5 crore cases pending in the judicial system. A case clearance rate of 100% (i.e. zero accumulation) can be achieved with the addition of merely 2,279 judges in the lower courts and 93 in high courts even without efficiency gains.

This is already within sanctioned strength and only needs filling vacancies. Scenario analysts of efficiency gains needed to clear the backlog in five years suggests that the required productivity gains are ambitious, but achievable. Given the potential economic and social multipliers of a well-functioning legal system, this may well be the best investment India can make.

To demystify the Survey and enable common people to access the ideas in it, the presentation of the Survey has important changes. Every chapter has an abstract and a 'chapter at a glance' which enable the reader to capture the gist of the chapter. Furthermore, these have been supplemented with short two minute videos on each chapter where we explain the main idea of the chapter. The videos have been constructed both in English and in Hindi to enable maximum number of readers to understand the Survey.

The Survey is a humble and sincere effort to live up to the expectation of being an indispensable guide for following, understanding, and rethinking the Indian economy.

SURVEY FOR NATIONAL MINIMUM WAGE LINKED TO GEOGRAPHIC REGION OR SKILL

The Economic Survey has strongly advocated removing wage disparity in the country to spur demand and proposed the creation of a national minimum wage that's linked to geographic region or skill and revised regularly.

"The central government should notify an 'a national floor minimum wage' that can vary broadly across five geographical regions", the survey said. "Thereafter, states can fix the minimum wages, which shall not be less than the 'floor wage'".

According to the survey, this step would bring some uniformity in minimum wages and would make all states almost equally attractive from the point of view of labour cost for investment as well as reduce distress migration.

The survey pitched for simplification and rationalization of minimum wages as proposed under the Code on Wages Bill. The code amalgamates the Minimum Wages Act, 1948, the Payment of Wages Act, 1936, the Payment of Bonus Act, 1965 and the Equal Remuneration Act, 1976, into a single legislation. The definition of 'wage' in the new legislation should subsume the 12 different classifications mentioned in various labour acts.

It suggested that the code should consider fixing minimum wages based on either of two factors – skill category or geographical region, or both. "This key change would substantially reduce the number of minimum wages in the country", it said.

Besides, it said the proposed Code on Wages Bill should extend the applicability of minimum wages to all sectors and cover both the organized and unorganized sectors. The Union Cabinet approved the wage code bill on Wednesday, and it will now be tabled in the current session of Parliament.

Vrijesh Upadhyaya, general secretary of Bhartiya Mazdoor Sangh said the wage code bill approved by the cabinet provides for a national floor minimum wage.

"The provision that this would be extended to all categories of workers and no state can offer wages less than the national minimum wage will give a big push to lift people out of poverty and boost demand", he said.

The present system in India is complex, with 1,915 minimum wages defined for various scheduled job categories across states. Besides, one in every three wage workers in India is not protected by the minimum wage law.

The number of scheduled jobs varies from three in Mizoram to 102 in Assam and it is in high double-digits in most states. The lowest notified minimum wage rate per day varies from Rs. 115 in Nagaland to Rs. 538 in Delhi.

"A well-designed minimum wage system can be a potent tool for protecting workers and alleviating poverty, if set at an appropriate level that ensures compliance", the survey said.

The survey recommended that the government ease labour laws to help create more jobs.

"Deregulating labour law restrictions can create significantly more jobs, as seen by the recent changes in Rajasthan when compared to the rest of the states", the survey said. "A comparison between the indicators for labour, capital and productivity of manufacturing firms

makes it clear that flexible labour laws create a more conducive environment for growth of industry and employment generation".

SELF-SUFFICIENCY IN EDIBLE OILS – A TALL ORDER

In her Union Budget speech, Finance Minister Nirmala Sitharaman has lauded farmers for making India self-sufficient in pulses, while being sure 'they will repeat such a success even in the production of oilseeds'.

On the first achievement, there are few doubts.

During 2016-17 to 2018-19, India's pulses output has averaged 23.92 million tonnes (mt), as against 17.58 mt for the preceding three-year period. As a result, imports, after more than doubling from 3.18 mt to 6.61 mt between 2013-14 and 2016-17, fell to 2.53 mt in the last fiscal. In value terms, pulses imports were only $1.14 billion (Rs. 8,035.30 crore) in 2018-19, having peaked at $.424 billion (Rs. 28,523.18 crore) two years before.

The Washington-headquartered International Food Policy Research Institute has projected the country's pulses demand under different GDP growth scenarios at 21.40-22.36 mt in 2020 and 25.22-28.07 mt by 2030. Given that current production is already at 23-25 mt, the self-sufficiency claims aren't entirely without basis. And the Narendra Modi government can probably take some credit for it.

But can the pulses ('vegetable protein') success be replicated in oilseeds ('vegetable fat')? The simple answer: It is a tall order.

Between 2009-10 and 2017-18, vegetable oil imports surged from 6.73 mt to 15.36 mt, with the corresponding foreign exchange outgo, too, rising from $4.72 billion (Rs. 22,316.68 crore) to $11.64 billion (Rs. 74,995.91 crore). They dipped somewhat to 15.03 mt ($9.89 billion or Rs. 69,023.80 crore) in 2018-19, but nowhere near the scale seen in pulses.

In 2001-02, the country's vegetable oil production, at 6.72 mt, exceeded imports of 4.76 mt. In 2011-12, imports crossed 10 mt for the first time, while also surpassing the domestic output of 8.15 mt. In the last oil year, imports, at 15.12 mt, were almost twice the production of 7.92 mt, translating into a self-sufficiency ratio of just over 34%.

The wholesale shift to imports has completely transformed the profile of edible oil consumption.

According to GGN Research, an Indore-based agri-commodity analytics firm, 58% of India's estimated edible oil consumption of 2.29 mt in 1973-74 was accounted for by groundnut. This was followed by mustard (28%), cottonseed (10%) and other indigenous oils such as coconut and sesame. But in 2001-02, 29.1% of the total consumption of 10.13 mt was constituted by palm oil, which, along with soyabean (22.3%), had relegated mustard and groundnut to third and fourth places. By 2017-18, the combined share of palm and soyabean oil had increased to more than 60%. Adding sunflower oil took it further up to nearly 72%.

About 96-98% of palm and sunflower oil consumed by India is imported – the former from Indonesia and Malaysia, the later mostly from Ukraine. The ratio would be lower, at 70-72%, for soyabean that is imported primarily from Argentina and Brazil. It is these three, predominantly imported, oils that are being largely used today for deep-frying *pooris* and *pakodas*, making the *tadka*/*chounk* tempering to add flavour and aroma to *dals*, and imparting

necessary texture, mouth-feel and bite to biscuits and cookies. While soyabean and sunflower are consumer-facing oils, not even a third of palm oil gets directly used in home kitchens. The bulk of it is consumed by the food industry – for everything from *mithais*, *namkeens*, bread and biscuits to noodles – and quick-service restaurants. It is the cheapest oil and amenable to deep as well as multiple frying. Hydrogenated vegetable oil (vanaspati), too, is entirely based on palm oil.

Against this background, how feasible is the goal of self-sufficiency?

B.V. Mehta, executive director, Solvent Extractors' Association of India, believes it is possible to push up production, particularly of mustard oil, which is currently around 2.2 mt. Mustard-seed has roughly 40% oil content. "Our average seed yield is hardly 1.2 tonnes per hectare. Punjab and Haryana together have six million hectares under wheat that the government is struggling to procure, amid overflowing godowns. If half that area is diverted to irrigated mustard with 2 tonnes/hectare yields, we can get an additional crop of 6 mt or 2.3-2.4 mt of oil," he notes.

The second biggest contributor to India's annual vegetable oil production of 8.81 mt is soyabean, at 1.3-1.4 mt. But since its oil content is only 17-18%, increasing production beyond even 2 mt is difficult. At No. 3 and No. 4 spots are cottonseed (1.2-1.3 mt) and rice bran oil (1 mt). Cottonseed, has, in fact, now become Gujarat's dominant indigenous oil, ahead of groundnut. The boost here has come essentially from the Bt (genetically modified cotton) revolution, just as increased paddy production has led to higher rice bran availability. A targeted approach can raise the output of these two oils by another 1.5-1.6 mt.

The real impetus to self-sufficiency, however, can come from oil palm – the only crop capable of yielding 4 tonnes of oil per hectare. "At present, local palm oil production is just 0.25 mt. India can potentially cultivate oil palm in 1.9-2 million hectares, giving 7.5-8 mt oil. But since the trees take four years to grow and yield fresh fruit bunches, you need to plan now. Oil palm should be declared as a plantation crop and exempted from land ceiling laws to attract investments from corporate. Simultaneously, we must restrict imports, especially of refined palm oil", adds Mehta.

On the other hand, industry expert and former Cargill India chairman, Siraj A. Chaudhry, is skeptical about aiming for self-sufficiency.

"Edible oil cannot be equated with pulses, where there's very little global trade and the consumption requirement of our significantly vegetarian population has to be met through domestic production. In edible oils, wheat or corn, there is no dearth of global suppliers producing at much lower costs. If China can import 100 mt of oilseeds annually (compared to its production of 58-59 mt), why should we worry about importing 15-16 mt of oil? Also, assuming our oilseed production rises substantially, where will you sell the resultant de-oiled cake or meal? Unlike China, our meat consumption isn't going to grow enough to absorb all this byproduct", he points out.