The Influence of the Brexit Process on the Banking System in Romania

Octav NEGURIȚĂ[1]

Abstract
The possible exit of Great Britain from European Union, even in the context of a relatively special status of British banking sector within the Community banking system, cannot remain without effects on the European financial system and thus on the Romanian banking system. The future process of adopting the euro in Romania will bring some changes, as it demands to transform certain mechanisms within the Community's financial and banking system. At European institutional level, the notion that a financial integration at Community level being not complete without the adoption of the single European currency is becoming more and more prevalent. It should not be ignored that the exit of this bloc from the community block may have possible effects on the foreign currency loans market. Similarly on the loans in *lei* too, even when we ignore less developed nature of interbank foreign exchange market. Changing interest rates as a policy instrument of monetary policy, both at the ECB level and at the NBR level will have limited effect.

Keywords: *Negotiation, eurozone, convergence, solvency, vulnerabilities*

[1] *PhD and Assoc. Prof of Financial and Accounting Management, Spiru Haret University, Bucharest.*
E-mail: octavnegurita@yahoo.com

INTRODUCTION

One of the most important consequences concerns the current principle of freedom to provide services directly on the territory of a Member State on the basis of the "EU passport". If, at present, United Kingdom membership of the European Union grants credit institutions and other financial institutions authorized and supervised by the competent UK authority the possibility of providing services on the territory of Romania (or on the territory of other Member States) through the establishment of branches or through the provision of services directly on the basis of a simple notification to the National Bank of Romania by the competent authority of the home Member State, upon leaving the European Union, this privilege will become inapplicable - which would hinder or discourage this type of service between Romania and the United Kingdom.

In other words, in order to provide services on the Romanian territory, in the absence of an "EU passport", credit institutions and other financial institutions in the UK will have to go through a much more difficult process of authorization, complex in terms of documentation and time, but also more expensive in order to achieve the necessary authorization from the National Bank of Romania.

Also, we must not ignore the loss of privileges with regard to the free movement of capital, such as the privilege of cross-border payments within the European Union, according to which the fees charged for cross-border payments within the European Union are the same as those charged for payments made in the same currency within a Member State. This principle will no longer apply between the UK and Romania with the withdrawal of the UK from the European Union. It is also worth recalling the possible impact on the principle of recognition of a judicial decision given in a Member State in the other EU Member States without the need for any special procedure in this regard, particularly considering the enforceability of the guarantee contracts governed by the Romanian law that secures loans governed by English law.

SYSTEMIC RISKS ON THE ROMANIAN BANKING SECTOR

Although they will only be felt after 2019, when Britain's outflow from the European Union will actually be consumed, Brexit's effects on Romania and other Central and Eastern European countries are not very well known

considering the future of their economies, depending on the strength of their growth. For Romania, theoretical losses of European structural and cohesion funds are estimated at 300-500 million euros annually as a result of Brexit, but they could only materialize after 2020. Romania has so far attracted some 15 billion euros, especially as a result of intensified efforts in recent years and reached an absorption rate of 82%.

It is expected that the EU budget "after Brexit" will have the same dimension and the EU members will have to increase their contribution, considering the financial agreement between EU and United Kingdom. Thus, Romania has, theoretically, to increase its contribution, affecting the beneficiaries of European funds in the region, the intensity of impact being not very well known. The Romanian government is based on a total financial allocation of about 31 billion euros from the Structural and Investment Funds (SIF), but for the period of 2014-2023, also after the effects of Brexit become reality.

In its financial stability reports, the National Bank of Romania (NBR) says Brexit's systemic risk is moderate. This can mean a lot in the coded terminology of the NBR. Although the implications will only be limited to the near future, Romania will have to calibrate its medium and long-term policies on the basis of the major challenges facing the EU. Brexit remains a factor of uncertainty, especially with regard to the long-term impact, largely depending on the outcome of the negotiations between the EU and the UK. As for the confidence in the euro, recent data show a reduction in Euroscepticism and an increase in consensus on the need to continue reforms to strengthen the institutional and economic framework of the EU.

For Romania, the difficulties in reforming euro area design and policies represent an important impediment to the extent that they are a disruptive factor in the EU's economic redeployment. An economic quasi-stagnation of the Eurozone for a longer period would seriously affect the economic growth capacity in Romania. One reason would be that our economy is low in relation to the euro area. It is therefore absolutely necessary for the Banking Union to have a more alert development on all the basic components, in order EU's euro area policies to be better outlined.

ROMANIA'S DEGREE OF INVOLVEMENT IN THE EUROPEAN SINGLE CURRENCY PROJECT

Starting in July 2015, Romania has met all the nominal convergence criteria linked to the inflation rate, the consolidated budget deficit, the government debt, the exchange rate against the euro and the long-term interest rates. Any departure from these conditions implies the prolongation of the ERM II period accordingly. In this context, ensuring the maintenance of macroeconomic equilibrium in the medium term has positive implications on the convergence process in addition to offering credibility to Romania when it has decided to start the process of joining the European monetary area.

According to the theory of optimal monetary areas, the cost-benefit balance of adopting a single currency depends, to a large extent, on the reduction of the development gaps between the states that form the Monetary Union and the compatibility between them, from the point of view of the economic structure, the degree of commercial integration or the synchronization business cycles in these economies. Therefore, in order to benefit from the adoption of the euro, it is not enough to meet, in a narrow sense, the Maastricht criteria. In fact, there is a need for a durable - and not accidental, forced or temporary - fulfilment of the nominal convergence criteria, which means the necessity to create the conditions for real convergence.

The NBR is fully integrated into the European System of Central Banks, and since 2011, the NBR has set up a Euro Preparation Committee. The adoption of the single currency is not simply a change of banknote, but a complex process involving primarily a political decision based on internal consensus and in agreement with the euro area partners. There is a need for a road map that will result in a target date as an anchor. Such a roadmap involves staging before entry into ERM II during the ERM II period and after entry into the euro area (Voinea, 2015). Assuming that Romania is ready to join today, it would take at least three and a half years to observe all the technical steps.

For Romania, it is vital that the European project does not fall apart; it is also important that Romania, over time, joins the EU's economic and political core, admitting that there will be a variable geometry after Brexit.

This strategic goal at the scale of history involves joining the Eurozone. However, joining the euro area, which is provided in the EU Accession Treaty and in the EU Treaty on the Functioning of the EU (TFEU), must be a rational decision, considering the lessons of the past decades and the major challenges faced by the EU.

EVOLUTION OF THE ROMANIAN BANKING SYSTEM CONSIDERING THE BREXIT STAGES

At aggregate level, between 2016 and 2017, the Romanian banking sector experienced a comfortable level of solvency. However, this general positive image has important nuances. First, the level 1 own funds in Romania is at the level of the EU average. In addition, there is a slight downward trend (from 16.4 percent in December 2015 to 16.1 percent in September 2016 and to 16.0 in October 2017). Under these circumstances, any measures to preserve and increase the solvency of the Romanian banking sector could not be interpreted as excessive compared to the European situation.

The Romanian banking system has prudential indicators of solvency, profitability and balance sheet structure better than the European average, while the quality of shareholders is discordant due to the low and bad credit rates with restructuring measures that are more than double the EU average. The prudential indicators of the Romanian banking system (solvency, coverage rate, profitability, balance sheet structure) are generally better than the European average, with two exceptions - the rate of bad loans and the restructuring rate. The European Banking Authority (EBA) publishes on a quarterly analysis (Risk Dashboard) which presents the main vulnerabilities of the European banking sector identified by the evolution of a set of risk indicators. The indicators are grouped into four categories: solvency, asset quality, profitability and balance sheet structure. And each indicator is evaluated against three prudence intervals, so its value can be considered very good, intermediate or deficient depending on the value range it belongs to.

The rate of bad debts and of loans with restructuring measures remain in the value band considered by the European Banking Authority to be "deficient", the level of these indicators being more than double the EU average. The non-performing loans (NPL) at the level of the entire banking

system reached around 13% at the end of March, continuing the downward trend last year. Bank balances have started to look better starting with the second half of 2014, improving the quality of portfolios as a result of troubled loan sales. However, the two vulnerabilities are diminished by the third indicator of asset quality analysis, namely the coverage ratio with non-performing loans, which places the Romanian banking system at the most prudent value range, over 58%, well above the average European, about 44%.

The financial health of the banking sector continue to remain robust. Solvency ratios remain at appropriate levels around the European average. Consistent capital buffers vs. prudential requirements provide good absorption capacity for unexpected losses and resources for lending to the real sector.

The balance sheet structure remained balanced in the first quarter of this year, respecting both the ratio of loans and deposits (around 80%) to total debt and equity (around 8%). The solvency ratios, which show how well the bank system is capitalized, maintain a high level for the best prudence range, slightly increasing over the past three years.

The results of stress testing of the banking sector reveal robustness at aggregate level in the event of adverse macroeconomic scenarios. The impact of the interest rate risk on the banking sector is important due to the longer-term asset structure, considering the backdrop of an important weight of fixed income items. The profitability of the banking sector has improved in the context of a favorable domestic macroeconomic framework, a significant reduction in net expenditures with depreciation adjustments, a prolongation of low financing costs, and a recovery in domestic currency lending. So we can say that the adoption process has not been influenced in this context, at least at the level of the process of adopting banking policies at national level.

The consolidation process of the Romanian banking sector continued in 2017, but at a slower pace. The outlook is accentuated, considering the strategic decisions of some banking groups present in Romania in order

to limit exposure in certain markets and the need to improve operational efficiency. The structural vulnerabilities of the reported banks' balance sheet, such as: (i) non-maturity mismatch of sources attracted to financial assets, or (ii) existing currency imbalances in which bank assets and liabilities are denominated, continued to be remedied.

For the banking sector as a whole, the balance sheet structure does not raise concerns considering the ratio between total debt and equity, which is within a prudent range, according to criteria established by the European Banking Authority. However, the ratio between loans and deposits continued to decline, and if these dynamics persist, risks may arise from a macro-prudential perspective (generated by the significant under-utilization of the resources that banks attract from the economy).

During the economic and financial crisis, Romania did not have to support the banking sector with public money, and the shareholders of the banks contributed to the additional capital. In 2008-2016, an equity of 3.5 billion euros was raised by banks. The years 2016-2017 were, for the banking market, the first years of return to a real operational profitability that it didn't have for a few years, amid the reduction in the cost of risk. ROA has registered over 1.00% and ROE has reached over 10.00%.

The banking sector performed well over the past year, as the process of optimizing the quality of the asset portfolio continued. The present rate of non-performing loans was down by 2.3 times to the maximum that was recorded in 2014. These are the indicators that show the long-term effectiveness of how money is used, namely own money or borrowed money through deposits or loans. In addition, the level at which the banking system in Romania is located is very high. It can show healthy activity, but at the same time the selling of expensive credits. The banking system has grown since lending activity has accelerated, especially for individuals.

The rate of non-performing loans as defined by the EBA has decreased to 9.46% at the end of December, 2016 and later to 8.32% in June, 2017. Thus, we continue to see a reduction in the non-performing loans ratio to the middle zone of the range, both through the stock-market balancing operations of the banking system and by reviving the secondary market for the sale of collateral in various execution phases. Capital requirements have increased, new liquidity rules have been introduced with an impact on the maturity of the asset structure, and credit risk assessment is much closer.

Considering this background, there is an orderly withdrawal mainly due to the absence of investment opportunities or less favorable return on capital. Thus, we can say that Romania has overcome the danger of disorderly withdrawals that have affected bank financing in the years of crisis, but the tendency to reduce exposure is still present. Under these circumstances, it is the responsibility of banks to secure their financing from local sources, and the fact that the banking system in Romania has returned to profit, even more operational profitability, is a very good indicator of these risks.

The increased limited availability of external financing for the Romanian banking markets indicates that deposits will have a relative attractiveness in the following years. As a result, the sustained increase in the volume of credit in Romania will be more closely linked to the increase in the volume of deposits. Moreover, some Eastern and Central European economies may experience a prolonged slow growth in the volume of credits. Credit-to-GDP ratios have relatively high levels in some CEE economies where incomes are lower. Moreover, certain market segments, such as consumer lending segment, do not appear to be underdeveloped in the Romanian economy. Consequently, credit growth in Romania will not be the same as in the last decade. Even though Central and Eastern European (CEE) lending growth rates will not be the same as in the last ten years, medium and long-term prospects for the banking sector remain extremely favorable.

POSSIBLE REASONS FOR THE SLOWING IN THE ADOPTION OF EURO BY ROMANIA IN THE CONTEXT OF BREXIT PROCESS

One of the factors that could lead to a delay in the adoption of the euro could be even negative repercussions on national economic developments. Romania recorded one of the highest economic growth rates in the EU in 2017, the main determinant being domestic consumption, while the trade balance, the public deficit and the inflation rate deteriorated. Investments did not make a significant contribution to the economic growth. These developments indicate the build-up of tensions with potentially significant negative consequences on future economic activity and implicitly on the financial stability.

An important factor in resuming the economic growth was the revitalization of global trade. Nevertheless, the risks of strengthening the growth rate of the global economy and of the international trade remain important, due to policies uncertainty, the accumulation of structural imbalances in emerging economies and the intensification of geopolitical tensions. International financial markets recorded positive developments in the first half of 2017 after the corrections recorded at the end of 2016, while volatility was on a downward trend with short growth periods.

An important systemic risk to financial stability in Romania, similar to the systemic risk at EU level, is related to the abrupt adjustment of the risk premium for emerging countries. In order to increase the role of the financial system over long-term economic growth, it is necessary to address these structural problems. As regards public sector indebtedness, the credibility of the implemented economic policies and the responsibility in managing public finances are important elements in ensuring investor confidence and implicitly a low cost of public debt financing. Recent developments do not indicate problems with the sustainability of external debt in the short term.

The refinancing risk decreased as the average maturity increased. Foreign FDI flows provided much of the funding needed for the current account deficit. An important systemic risk to financial stability in Romania, similar to that at EU level, is the general adjustment of the risk premium for emerging economies. The implementation of a policy mix that is conducive to maintaining macroeconomic balances represents an important condition

for limiting the contagion effects from international financial markets, given the risk of a sudden change in investor confidence in emerging economies.

Brexit remains a factor of uncertainty, especially with regard to the long-term impact, largely depending on the outcome of the negotiations between the EU and the UK. As for the Romanians confidence in the euro, recent data show a reduction in Euroscepticism and an increase in consensus on the need to continue reforms to strengthen the institutional and economic framework of the EU. Europe's bank profitability slightly improved in the first half of 2017. Thus, return on equity (ROE) rose by 3.7 percentage points in the second quarter of 2017 compared to the last quarter of 2016, reaching 7 percent. Also, return on assets (ROA) rose to 0.45 percent over the same period, from 0.21 percent at the end of 2016.

Romania is among the countries with the highest level of banking profitability, along with other countries in the region. Romania recorded one of the highest economic growth rates in the EU in 2017. However, the analysis of the main macroeconomic indicators reveals the accumulation of tensions, with potentially significant negative consequences on future economic developments and implicitly on financial stability. Against this background, the continuation of the convergence process is conditioned by the recalibration of the policy mix so as to ensure the sustainability of the fundamental economic indicators.

Cooperation between institutions having a role in the coordination of economic policies is essential for achieving an optimal mix of policies for the Romanian economy. Until now, Romania has gone through a continuous process of convergence, even during the economic crisis. However, inflationary tensions and budget deficits have accumulated.

A critical mass of companies has been formed in Romania to meet the challenges of eventual joining the Eurozone. According to the recent developments (Neagu et al., 2017), the number of companies making the critical mass is relatively low (below 10 percent of the total number of active companies in the economy). These companies have recorded higher economic and financial performance indicators than the rest of the economy and are the basis for a sustainable economic growth. Thus, we can say

that the activity of the Romanian economic societies was not negatively influenced, even in the current context of the post-Brexit negotiations, in the conditions in which the trade balance with the UK was one of the few with which Romania has a favorable value to our country.

It should not be overlooked that the Eurozone itself has to go through the reform process. In order to complete the Banking Union, the European Deposit Guarantee Scheme (EDIS) must be operational, minimum own funds and eligible debt requirements (MRELs) must be established. Also, it has to clarify the contradiction between bank micro-prudential consolidated supervision and the national responsibility for resolution. There is no consensus either on the creation of the Fiscal Union or on debt mutualisation, while the Union of Capital Markets represents still an early process. Other structural reforms at European level should seek to find a replacement for EURIBOR, should seek to implement unitary rules of transparency, reporting and accountability for buyers of bad credit packages, and should seek to modify the treatment of sovereign exposures in order to recognize the absence of zero risk.

Even if there are, at least partly justified, opinions on adopting other types of criteria regarding Romania's capacity to adopt the euro, we cannot ignore the basic principles regarding the adoption of the euro by any state. Along with six other countries (Bulgaria, the Czech Republic, Croatia, Poland, Sweden, Hungary), Romania is among the Member States of the European Union which have the obligation to adopt the euro, which means, in practice, full participation in the Economic and Monetary Union, once all the necessary conditions have been met, namely the nominal, legal and real convergence criteria. The latter are not explicitly mentioned in the relevant EU legislation, but they are becoming more and more important in assessing the state's readiness for the adoption of the single currency.

In fact, the Convergence Reports, developed every two years by the European Central Bank and the European Commission, are increasingly focusing on real convergence. Thus, in the run-up to the adoption of the single currency, the national economy must undergo the necessary adjustments to the euro area, marked by broad structural reforms, with effects on its overall competitiveness.

At the time of the drafting of the 2016 Convergence Report of the European Central Bank, Romania fulfilled all the criteria of nominal convergence and only part of the criteria of legal convergence. The 2017-2020 Convergence Program states that the Romanian Government remains committed to joining the Eurozone, but the establishment of a concrete date in this regard requires the carrying out of in-depth analyses, especially regarding the real, structural and institutional convergence areas where major progress is needed.

From the data set out in the ECB 2016 Convergence Report, we can conclude that the Romanian economy was not influenced by the UK dictatorship of leaving the EU, the trend of macroeconomic indications being relevant in this respect. Also, the observations made regarding the evolution of these indicators refer only to the influences of domestic economic problems in Romania and not to external influences, whether they are ecological, political or social.

The average annual HICP inflation recorded by Romania in the last 10 years fluctuated within a relatively wide range, ranging from -1.3% to 8.5% and the average of the period were at a high level of 4.5%. Looking ahead, there are concerns about the sustainability of inflation convergence in Romania for a longer period. It is likely that the gap recovery process will lead to positive inflation differentials in relation to Eurozone.

In Romania, the budget deficit and public debt fell to the levels set by the Maastricht criteria. Romania is the object of the preventive component of the Stability and Growth Pact from 2013 onwards. According to the Ministry of Finance reports, the budget deficit in 2017 registered a share of 2.83% of GDP, below the 3% of GDP ceiling for the budget deficit.

During the 10 years spent as a member of the U.E., the Romanian currency did not participate in ERM II, but was traded under a flexible floating rate regime. The exchange rate of the Romanian currency in relation to euro currency has, on average, displayed a relatively high degree of volatility in the reference period. The cumulative balance of Romania's current and capital account has experienced substantial improvement over the past 10 years, but the value of net external liabilities, although gradually

narrowing, remains at high levels. Also, in the reference period May 2015 - April 2017, long-term interest rates were on average 3.6% lower than the benchmark of 4.0% on the benchmark interest rate convergence criterion.

In Romania, long-term interest rates have been on a declining trend since 2009, with 12-month average rates falling from around 10% to below 4%. On a legislative level, Romania still does not fulfil all the central bank independence requirements, the ban on monetary financing and the legal integration of the central bank in the Euro-system. However, our country is subject to derogation and must therefore comply with all the adaptation requirements laid down in Article 131 of the Treaty.

Thus, it is questionable which of the indicators could be most affected by the UK detachment from the EU. Probably the only indicators influenced in this sense would be the budget deficit and the public debt. At budget level, at least until the 2020 horizon, Romania would not have any influence because the United Kingdom will participate with the same amount in the European Union budget, and after that year it will be registering budget regressive budgets. By 2020, the only problem that can arise will be to increase the capacity of our country to absorb the available Community funds, a problematic point in this context. If our country succeeds, even to a lesser extent, in increasing the absorption of EU funds, Romania's budget will not be influenced by the increase of our country's contributions to the EU budget that will take place after 2020.

Another aspect is the evolution of the trade relationship that our country has with the UK, a relationship that has led to a positive balance for our country as well as one of the only ones registered with the U.E. It is obvious that the UK will want to sustain, at least at the same pace, the trade relations with the EU Member States, a reason for this being the negotiations for a trade agreement valid after the UK's effective exit from the EU. The vote in 2016 did not trigger an inversion of Romania-UK trade relations, with the figures even recording an increase in import-export volumes.

Romania has reached a certain degree of real convergence with the EU. There are, of course, great gaps in the degree of economic development (GDP / inhabitant), in the structure of the economy, in the quality of the

infrastructure, the functioning of the institutions, the living standards, etc., but Romania's foreign trade is mainly carried out with the other EU countries. This reorientation of foreign trade over the past two decades has been largely determined by foreign direct investment, which, although smaller than other countries in the region, is the main source of foreign financing for the Romanian economy. As a result of this factor's action, in terms of commercial integration (the common market), Romania is more integrated into the EU than it was when countries like Greece, Portugal and Spain joined the EMU.

Romania participates in the "European System of Payments in Euros" - TARGET 2 and started to implement some elements of the "European Banking Union" - UEB (the single regulatory framework on capital requirements, the "Unique Resolution Mechanism" URM, European Deposit Guarantee Fund "- EDGF, etc.). In other words, we could say that Romania is already in a rather advanced phase of financial integration in the euro area. In this context, highlighting the difficulties and the risks of the early adoption of the euro seems overly negative. There is fear that by adopting the euro the real interest rates in Romania would become smaller than the equilibrium ones, which would lead to the artificial growth of credit and the emergence of speculative bubbles in real estate. However, the interest rate (real or nominal) is a theoretical size, not an observable size.

The assertion that actual interest rates on the market are or will be lower, equal to or higher than the equilibrium level, cannot be verified empirically even before and especially in the next period. Second, equilibrium interest is not a forever given size because demand and supply of credit are constantly changing. In Romania, the credit supply comes mainly from subsidiaries and branches of foreign banks whose head office is located in Eurozone countries and are already subject to the UEB and single monetary policy. Finally, lowering interest rates stimulates investment and, therefore, economic growth, which is exactly what Romania needs to do to recover the gaps.

There is also the idea that accession to the euro-zone could be hindered by the appreciation of the evolution of Brexit, which would have negative effects on the external competitiveness of the Romanian economy. Such

an evolution is unlikely to be due to the current account deficit and the decrease in capital inflows. The evolution of the past two years denies this theory, the Romanian currency showing a downward trend towards the euro starting with the third quarter of 2016 against the British currency. Since the financial crisis, the Romanian currency has remained in the stability claimed by the exchange rate mechanism II (ERM II), indeed with a support from the IMF loan, instead of the ECB's support, this being the best credibility element that the Romanian economy can cope with the requirements of the euro adoption.

Romania's decision to move to the euro has to come together with others, which set a much wider framework of Union issues and policies if it is to draw a realistic perspective of the process of European integration. The Union has reached a high degree of complexity. The package decision to adopt the single currency must be based ab-initio and on the option of a fundamental approach to the opportunities of the moment. Perhaps their optimal use is related to the way we see the resolution of the crisis of the Union nucleus, the European Monetary Union.

The problem is not whether Romania needs to adopt the euro or not, but whether it gains more benefits by waiting or entering EMU quickly. In principle, in relation to this issue, as with other aspects of the post-communist era, two positions can be formulated: "gradualism" or "shock therapy". According to the first position, entry into the EMU should be the result of a long process of real convergence of the Romanian economy. The arguments of the advocates of this position are based on highlighting the many stringent conditions on which it depends - beyond the Maastricht criteria of convergence - the successful adoption of the euro. According to the second position, to which we subscribe, the adoption of the euro must be done as quickly as possible, since membership in the EMU favors a faster real convergence of the economy and thus, an easier recovery of the immense gaps that separate Romania from the developed part of Europe. As a result, the main issue is not the fulfillment of economic or technical criteria, but the politics abandoning the autonomy of national monetary policy and competently and responsibly participating in the work of developing and implementing the common monetary policy.

CONCLUSION

As far as Romania is concerned, the prospect of preserving the net income (in a generic sense), which is otherwise necessary, requires a serious internal structural fiscal reform (budget revenue is only 28% of GDP), to provide complementary resources, not only following the outbreak of the UK, but also of the restructuring of the Union's funded objectives and, possibly, the increase in co-financing, which makes the access to Union funds conditional. The most relevant example, namely the idea we must become more accustomed to if we want more public goods and services from the Union is investing in our capacity and solidity to offer them.

Reforming the European Union, especially in the context of Brexit's production, is a great opportunity for Romania to get out of a shadow of passivity that is otherwise recognized. The balance of the 10th anniversary of joining with the good and the less good, and the way we should see the participation in the European integration process until now offer us serious arguments to put strong themes of mutual interest in the negotiation bases much more balanced.

As a political project, the euro was a complex investment with multiple and large initial costs up to its physical realization (currency in circulation, issuing bank, price stability mandate), putting it into circulation and supporting its course towards the vicissitudes of the complex environment (renouncing national monetary policy, renouncing national currencies, a single monetary policy and even survival with the disadvantages of a single monetary policy in the absence of a fiscal pillar, etc.). The euro could not be thought of without benefits, and these - along with the costs - cannot be reduced to a simple mathematics. Recovering the initial "investment" for the single currency is itself the completion of the European project, a process in which Romania is hired as a Member State, and the option of completing its own European project, as a Member State, cannot be cost-benefit-related mathematically determined, but only by what the Union wants with Romania at the table of its decisions.

The legal exemption granted by Romania, with no expiry date, cannot be interpreted as permanent (unlike the express and explicit cases of Great Britain and Denmark, but may be modified) and therefore the "obligation"

of the euro adoption cannot be challenged for economic reasons or political considerations ex post signing the Accession Treaty interpreted as disadvantages or eventually high opportunity costs, when in fact the choice of the moment is the right of the Member State without being exercised on a certain date.

REFERENCES

[1] Cerna, S. (2016). De ce să amânăm trecerea la adoptarea euro? Trecerea la euro în 2019 este posibilă și ar putea fin un moment astral în istoria recentă a României. Retrieved from http://www.zf.ro/opinii/de-ce-sa-amanam-adoptarea-euro-trecerea-la-euro-in-2019-este-posibila-si-ar-putea-fi-un-moment-astral-in-istoria-recenta-a-romaniei-15740711 accessed on 20.08.2017.

[2] Dăianu, D., Kallai, E., & Socol, A. (2017). România și aderarea la zona euro: întrebarea este, ÎN CE CONDIȚII. Retrieved from http://zbw.eu/econis-archiv/bitstream/handle/11159/153/Studiu_euro_SPOS_2016.pdf?sequence=1&isAllowed=y accesed on 29.01.2017

[3] European Central Bank. (2016). Raport de convergență Iunie 2016. Retrieved from http://www.ecb.europa.eu/pub/pdf/conrep/cr201606.ro.pdf?2c4cc232f10de64f1976b9ffda2abc74 accesed on 21.01.2017

[4] Ionescu, A. (2017). România și BREXIT: Pagubele Bucureștiului în comparaţie cu ţările Europei Centrale şi de Est. Efecte limitate pe termen scurt, mari amenințări pe termen lung. Retrieved from http://cursdeguvernare.ro/romania-si-brexit-pagubele-bucurestiului-in-comparatie-cu-tarile-europei-centrale-si-de-est-efecte-limitate-pe-termen-scurt-mari-amenintari-pe-termen-lung.html accesed on 21.11.2017.

[5] Medrega, C. (2016). Sistemul bancar românesc este cu mult peste media UE la mai mulţi indicatori de risc, cu excepţia ratei creditelor neperformante şi cea a creditelor restructurate. Retrieved from http://www.zf.ro/banci-si-asigurari/sistemul-bancar-romanesc-este-cu-mult-peste-media-ue-la-mai-multi-indicatori-de-risc-cu-exceptia-ratei-creditelor-neperformante-si-cea-a-creditelor-restructurate-15500706 accessed on 25.09.2017.

[6] Moloney, N. (2017). Financial services, the EU, and Brexit: an uncertain future for the city?. LSE Reasearch Online. Retrieved from http://eprints.lse.ac.uk/67292/1/Moloney_Financial_Services_the_EU_and_Brexit.pdf accesed on 08.12.2017.

[7] Mușat & Asociații Analyse. (2016). Impactul pentru bănci, burse, concurenţă, drept comercial, dreptul muncii şi fiscalitat. Retrieved from http://www.zf.ro/banci-si-asigurari/analiza-brexit-musat-asociatii-impactul-pentru-banci-burse-concurenta-drept-comercial-dreptul-muncii-si-fiscalitate-15519922 accesed on 12.12.2017.

[8] National Bank of Romania. (2017). Raport asupra stabilității financare decembrie 2017. Retrieved from http://www.bnr.ro/DocumentInformation.aspx?idDocument=26693&idInfoClass=19966 accesed on 07.01.2018.

[9] National Bank of Romania. (2017). Raport asupra stabilității financiare mai 2017. Retrieved from http://www.bnr.ro/DocumentInformation.aspx?idDocument=25183&idInfoClass=19966 accesed on 25.09.2017.

[10] National Bank of Romania. (2017). România și adoptarea euro. Retrieved from http://www.opiniibnr.ro/content/romania-si-adoptarea-euro.pdf accesed on 30.10.2017.

[11] Neagu, F., Dragu, F., & Costeiu, A. (2017). Pregătiți pentru viitor? O nouă perspectivă asupra economiei Romaniei. Retrieved from www.bnr.ro%2Ffiles%2Fd%2FPubs_ro%2FCaiete%2F2017cs46.pdf&usg=AOvVaw3xYgx92UrbolewX_QU7quC.

[12] Romanian Banks Association. (2016). Sistemul bancar din România. Retrieved from http://www.arb.ro/sistemul-bancar-din-romania/sistemul-bancar-din-romania/ accesed on 28.11.2017.

[13] Voinea, L. (2015). O perspectivă asupra foii de parcurs pentru adoptarea euro. Preparation committee on the changeover to the euro. National +Bank of Romania.

The Make in India Initiative: Has it Worked?

Lalita SOM[1]

Abstract
Manufacturing sector has the potential to lift half a billion more of India's population out of poverty through income, export and employment growth. For a broad economic growth, India must focus both on domestic production to satisfy its large domestic demand and producing goods for global markets. However, value added manufacturing, as a percentage of GDP, has remained constant since 2000. *Make in India* was launched in 2014 to bring manufacturing back into the spotlight. The article looks at the relevant progress made since the launch of *Make in India*. Since then, the country has improved its rank consistently and has seen a significant jump of 30 places in 2017 in the World Bank's annual ease of doing business survey and has eased statutory restrictions on foreign direct investment across sectors. Consequently, FDI inflows saw a rise, but the investment to GDP and the ratio of value added manufacturing to GDP have been declining. The downward trend in many of the economic variables like the current account has been unambiguous since the beginning of 2017. There is a broad consensus amongst commentators about the downward trend in the economic variables related to manufacturing and the structural impediments facing manufacturing in India. To achieve the objectives of *Make in India*, India must position itself to benefit from the structural changes in technology and other emerging forces of globalization. For this, India needs to address a number of structural bottlenecks, which have intensified India's loss of competitiveness in the manufacturing sector. The article discusses the ten most important of these structural impediments and evaluates the progress India has made since the launch of Make in India and bolsters its arguments with international indices capturing trends in those structural variables. However, it is too early to call *Make in India* a success or a failure. Although India has introduced some significant policy changes, the success of these policies is dependent on their effective implementation.

Keywords: *Make in India, manufacturing value added, factor markets, infrastructure, regulatory bottlenecks.*

[1] Lalita Som has worked for the Organization of Economic Cooperation and Development in Paris.
She can be reached at lalita.som@gmail.com.

INTRODUCTION

During 2003-08, a big reason for optimism in the Indian economy was higher capital expenditure by private firms, which rose during that period by 36 percent of GDP. The 26 percent decline in corporate investment since then has been the single biggest cause of India's slowdown.

Value-added manufacturing accounted for only 16.5 percent of India's GDP, compared to the services sector which contributes nearly 53.8 percent to the GDP in 2016 (World Bank, 2017). Manufacturing value-added as a percentage of GDP has remained more or less stagnant since 2000.

In terms of employment, manufacturing has not been a major long-term driver of job creation in India. After fluctuating around 11 percent for some time, it increased quite strongly to 12.6 percent in 2011-12 before declining to 10.7 percent in 2013-14 (ILO,2016). Between 2004-05 and 2011-12, when total employment outside of agriculture rose around 51 million, only 6 million jobs were created in manufacturing. Most of them were informal jobs.

Although, the share of merchandise exports in GDP increased from about 8 percent in 1999–2000 to 16.8 percent in 2013–14, India's share in global merchandise exports has remained low. India represents slightly more than 2 percent of the world's manufacturing output, a tenth of what China contributes.

To capitalize on the demographic dividend, India must create nearly one million jobs per month over the next decade. Manufacturing is seen to have the potential to provide large-scale employment to the young Indian population, at a time when manufacturing jobs are shrinking globally and a new global economic paradigm is emerging, driven by the rapid growth in digital technologies. A McKinsey study finds that rising demand in India, together with the multinationals' desire to diversify their production to include low-cost plants in countries other than China, could together help India's manufacturing sector to grow six-fold by 2025, to $1 trillion and could create up to 90 million domestic jobs (Dhawan, Swaroop & Zainulbhai, 2012).

With this conviction, the current government launched the *Make in India* initiative in 2014, aimed at making India a global manufacturing hub by urging investors to think of India not only as a big emerging market, but also as a place for production. 'Make in India' is designed to facilitate investment, foster innovation, protect intellectual property, and build best-in-class manufacturing infrastructure in India.

The ambitious initiative represented an attitudinal shift in how India relates to investors: not as a permit-issuing authority, but as a facilitator of business and as a business partner. The initiative identified 25 growth sectors, and includes the creation of a website through which companies can seek policy clarifications within 72 hours.

The plan specifically included proposals to cut red tape, develop infrastructure and make it easier for companies to do business. In 2014, India ranked 134th (out of 189 countries) in the World Bank's ease of doing business survey. Measures to reduce complexity and to improve transparency in regulation have been therefore a significant part of the *Make in India* initiative. An investor facilitation team was set up to be the first reference point for guiding foreign investors on all aspects of regulatory and policy issues.

This article looks at the progress that India has made in the last three years since the launch of the *Make in India* initiative and whether economic reforms have strengthened the country's manufacturing ecosystem sufficiently to make it a viable global manufacturing hub.

THE ROLE OF MANUFACTURING IN ECONOMIC GROWTH AND EMPLOYMENT

Since the industrial revolution, almost all countries that have managed the transition from low to high income have undergone industrialization, diversifying and upgrading their production structure, reducing their dependence on agriculture and natural resources. Understanding the channels through which manufacturing growth affects economic growth and employment, is essential to consider how Make in India will mobilize higher labor absorption and lead to better economic outcomes.

Kaldor examined the relationship between industrial development and economic growth, and based on empirical results, characterized the manufacturing sector as "the main engine of fast growth" (Kaldor, 1967). He argued that manufacturing had the capacity to generate 'dynamic increasing returns' i.e. manufacturing not only has the potential to increase its output more than proportionate to the increase in inputs (i.e. increasing returns to scale), but also, the faster the rate of growth of output in manufacturing, the faster the rate of growth of both manufacturing and economy-wide productivity (dynamic increasing returns) (Thirlwall, 1983). This implies that manufacturing is the core driver of GDP growth and employment while the service sector is likely to grow on the basis of the growing demand derived from (and resulting from) an increasing GDP.

This not only was true for the 12 early industrializers Kaldor examined, from UK to Japan, but was also the characteristic of South-east Asian countries that have experienced rapid, sustained growth. The 2008 Commission on Growth and Development identified common features of catching up countries that have achieved 'episodes of high and sustained growth' in excess of 7% per annum for 25 years or more (World Bank,2008). Nine of the thirteen success stories were cases of manufacturing-led growth: Brazil, China, Indonesia, the Republic of Korea, Malaysia, Singapore, Taiwan, China and Thailand. Only a few countries endowed with natural resources, and with small populations, have gone through a period of sustained economic growth without advancing manufacturing production, like Botswana and Oman. In recent years, however, very few countries have achieved such a sustained period of high growth and job creation, other than China.

A number of researchers have tested Kaldor's hypotheses across a range of developing countries (Dasgupta & Singh, 2005) (Wells & Thirlwall, 2003). They found that manufacturing has a positive correlation with GDP growth. Szirmai and Verspagen (2015) tested the relationship between the value-added share of manufacturing and growth of GDP per capita. This relationship was examined for three periods, 1950–1970, 1970–1990 and 1990–2005, and compared with the service sector. It was found that manufacturing acts, as an engine of growth for low and for some middle-income countries, provided they have a sufficient level of human capital. The findings for more recent periods indicate that a higher level of human

capital (at least 7-8 years of education) is necessary for manufacturing to play the role of engine of growth in developing countries (Adam & Verspagen, 2015).

In India, Chakravarty and Mitra (2009) found manufacturing to have been one of the drivers of growth, together with construction and services between 1973-2004 period (Chakravarty & Mitra 2009). For the period between 1994-2006, Kathuria and Raj (2013) found that in 15 states manufacturing had indeed acted as an engine of growth in India, despite its declining share in GDP (Vinish & Natarajan, 2013).

India is part of the general trend of premature deindustrialization which is prevalent in developing countries with the share of manufacturing value-added (MVA) relative to that of other sectors and employment decreasing significantly. However, it has been widely witnessed that manufacturing jobs are shrinking globally as the service sector's share of production and employment is large and growing in most advanced and many developing countries. The growth of productivity and of income has historically appeared to slow once factors of production began to shift from manufacturing to services (Baumol,1967). This phenomenon facing the global economy is the 'post-industrial' state in which development does not rely on industrialization. This phenomenon could be especially worrisome for developing economies where employment shares are shifting from agriculture to services, bypassing manufacturing, given that skipping the industrialization phase could constrain their ability to narrow income gaps (Rodrik, 2016).

The model of globalization that shaped the economic growth of countries - from low to medium / high income and that followed the transition from agriculture to light manufacturing and rapid growth of exports, followed by development of heavy industry and then services - has been disrupted today by the growth in digital technologies, including manufacturing technologies. These new technologies are resulting in large-scale manufacturing and global merchandise exports losing their primacy as drivers of growth and jobs in the medium to longer term. In addition, the competitiveness of countries with low cost labor advantage is eroding due to growing local regulation and protectionism. Given these global policy and technology shifts, is India's focus both on domestically-oriented production to satisfy

large domestic demand and producing goods for global markets a viable economic model? Although a stronger manufacturing sector could help link India to global supply chains, boost exports, and create jobs, is Make in India too little, too late? India needs to adapt its policies to reflect the changing nature of the industry and accommodate changes over many policy areas simultaneously.

MAKE IN INDIA AND ITS PROGRESS SINCE THE LAUNCH

Despite the advantage of low level wages and the rapidly eroding availability of abundant labor force, there is unanimity in that India would have to compete against most countries in the production and export of manufactured goods. Whereas India has been unable to do so; so far it is due to rigid labor and taxation laws, difficult process of land acquisition, regulation, and poor infrastructure; all of these have been significant constraints in achieving higher growth targets.

Nonetheless, over the past decade, the country's auto industry has been an exception to the general decline in manufacturing. According to the Society of Indian Automobile Manufacturers (SIAM), in terms of output—more than 3 million cars have been produced in India since 2011-12. In the mid-1990s, India opened its automobile industry for the investments of foreign manufacturers. By the early 2000s, India had become a global source for auto-components supplying global car manufacturers for their local as well as global supply chains. In the late 2000s, Indian automakers began to acquire auto companies overseas. Participation of foreign manufacturers provided the technology in making Indian parts and vehicles competent with global standards. In 2004, India produced 1.18 million cars, and by the end of 2016, it produced 3.68 million cars. The auto industry contributes 7 percent of GDP and employs, directly or indirectly, around 19 million people (SIAM). The challenge for Indian policymakers is to repeat the success achieved in the automobile sector in other manufacturing sectors.

Manufacturing is key to generating the jobs required to employ the 12 million new entrants to the labor market each year. While value-added services have provided 54 percent of India's GDP and especially the information-technology sector has contributed to 67 percent of India's services exports, Indian manufacturing has trailed not only that of East

Asian countries such as South Korea and Taiwan, but also of smaller economies like Vietnam and Bangladesh. As a percentage of GDP (16.5 percent), manufacturing in India has remained unchanged since the liberalization of economic activity in 1991. In comparison, manufacturing accounts for 29 percent of economic output in China and South Korea, and 27 percent in Thailand.

It is not surprising then that India plans to raise manufacturing as a percentage of GDP from 17 percent to 25 percent, and to create 100 million jobs within a decade. The 2014 National Manufacturing Policy (Make in India) addressed the areas of regulation, infrastructure, skills development, technology, availability of funding, exit mechanism etc. It is unlikely that India will be able to replicate the manufacturing success of its East Asian peers as its prospects will transect with global technological and economic trends. The rise of automation has raised questions about whether a focus on manufacturing can lead to a faster economic growth.

India has a revealed comparative advantage (RCA) only in a small number of manufacturing sub-sectors when compared to other emerging economies, according to the OECD data on trade in value-added. In addition, when a manufacturing sub-sector displays an RCA, it tends to be relatively small, as for example in the case of the production of textiles, textile products, leather and footwear. The main exception is the jewelry sector, where India has a significant RCA (Kaldor, 1967).

However, an IMF study (Thirlwall,1983) suggests that India has immense potential to diversify into products (emerging RCA) that are closely related to its current capabilities. In addition, it has good potential in expanding the exports to new areas, increasing the share of manufacturing in exports, increasing the sophistication of goods, and in improving the quality and complexity of exporting products. These products with emerging RCA belong to the 25 growth sectors as recognized by the *Make in India* initiative. *Make in India* took steps in the right direction by recognizing sectors with emerging comparative advantage.

Since the launch of *Make in India*, the country has improved its rank consistently and has seen a significant jump of 30 places in 2017 in the World Bank's annual ease of doing business survey (Figure 1) and has

eased statutory restrictions on foreign direct investment across sectors (as measured by the OECD's FDI Regulatory Restrictiveness Index (Figure 2) where restrictions are evaluated on a 0 (open) to 1 (closed) scale).

Figure 1: Ease of doing business index

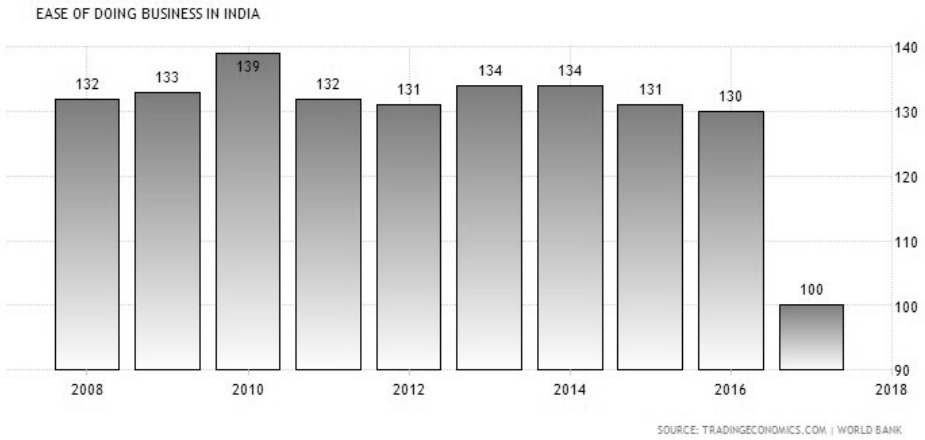
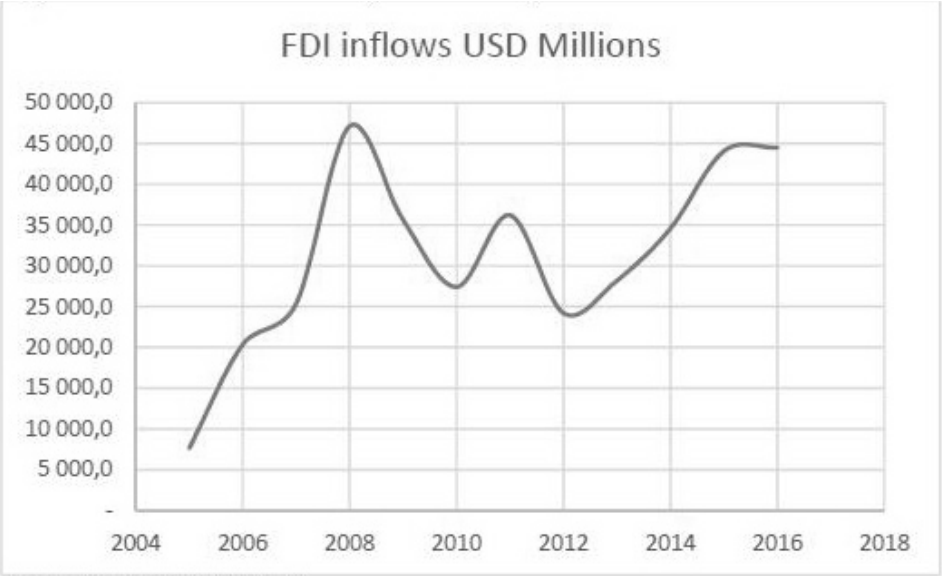


Figure 2: OECD FDI Regulatory Restrictiveness Index

Source: OECD FDI Regulatory Restrictiveness Index – extracted 25 September 2017.

Current FDI policy in India is considered among the most liberal compared to other emerging economies. FDI of up to 100 percent is allowed under the automatic route in most sectors and activities. FDI inflows have grown by 15 percent between 2014-16 (Figure 3). In 2015, India surpassed China to become the top destination for FDI in Asia, attracting around US$63 billion investment flows. However, the number of greenfield FDI projects in India during 2017 fell sharply by 21% according to the 2018 FDI Report. China received foreign capital investment of $50.8 billion in 2017 in greenfield projects, where India attracted $25.1 billion.

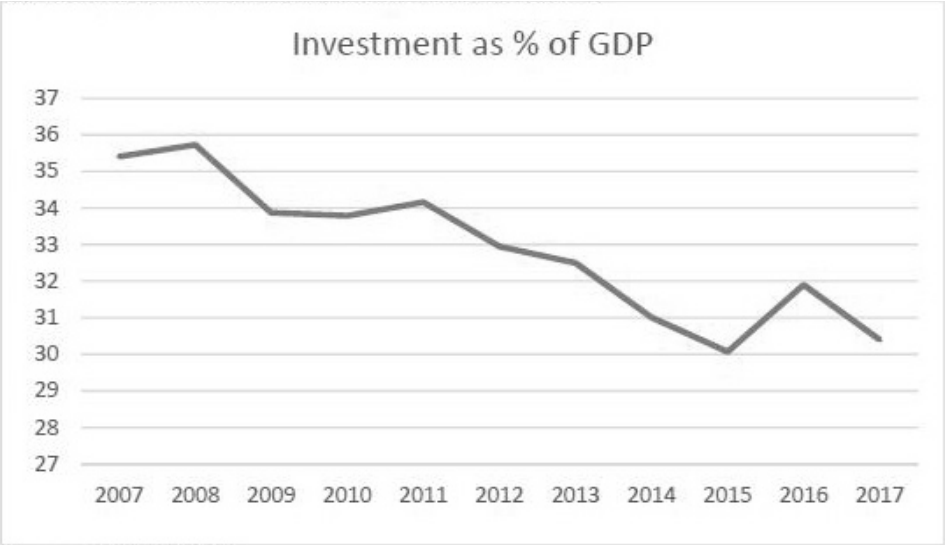
Figure 3: FDI inflows to India (USD Millions)



Source: UNCTAD, WIR 2017.

Although FDI inflows were on the rise between 2014-16, the declining investment to GDP ratio (Figure 4) suggests FDI flowing towards brownfield investments in the face of collapsing domestic private and public investment.

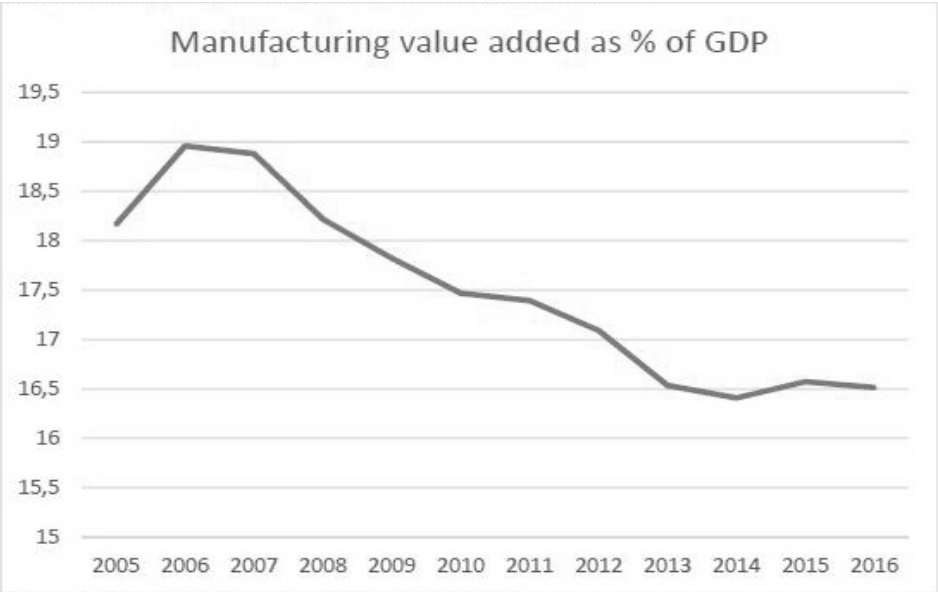
Figure 4: Investment (GFCF) as a percentage of GDP



Source: OECD (2017)

Falling domestic investment has mirrored the decline in value-added manufacturing in India's GDP (Figure 5) (World Bank, 2008).

Figure 5: Contribution of manufacturing to India's GDP



Source: data.worldbank.org extracted on 11 Oct 2017.

Figures on real gross value-added (GVA) for 2015-16 revealed that higher growth rates were spurred by strong industrial growth (Table 1). In 2015-16, growth in agriculture and related activities were estimated at just 1.2 percent while growth in the industrial and services sectors reached 7.4 and 8.9 percent respectively. The growth rate in manufacturing at 9.3 percent in 2015-16 was credited to the *Make in India* initiative.

Despite this sudden elevated growth rate in real GVA for the years 2015-16 (concerns have been raised that the new National Accounts Statistics (NAS) Series significantly over-states growth in manufacturing), there is no denying that the share of manufacturing in economic activity has revealed a downward trend since 2012-13.

Figures 6, 7 and 8 on IIP, India's manufacturing production and PMI demonstrate this declining trend.

Table 1: Real GVA growth in Indian manufacturing (%)

	2012-13	2013-14	2014-15	2015-16
Real GVA from the new NAS (base 2011-12)	6.0	5.6	5.5	9.3
Real GVA in manufacturing obtained from ASI data	6.5	2.0	NA	NA
Real GVA in private sector manufacturing companies covered in the RBI quarterly survey	1.7	0.9	3.3	9.7
Index of Industrial production, manufacturing	1.3	-0.8	2.3	2.0
Real GVA from the previous NAS series (base 2004-05)	1.1	-0.7		

Source: Goldar (2016)

Figure 6: Growth India industrial production index %
(covers mining, manufacturing and electricity)

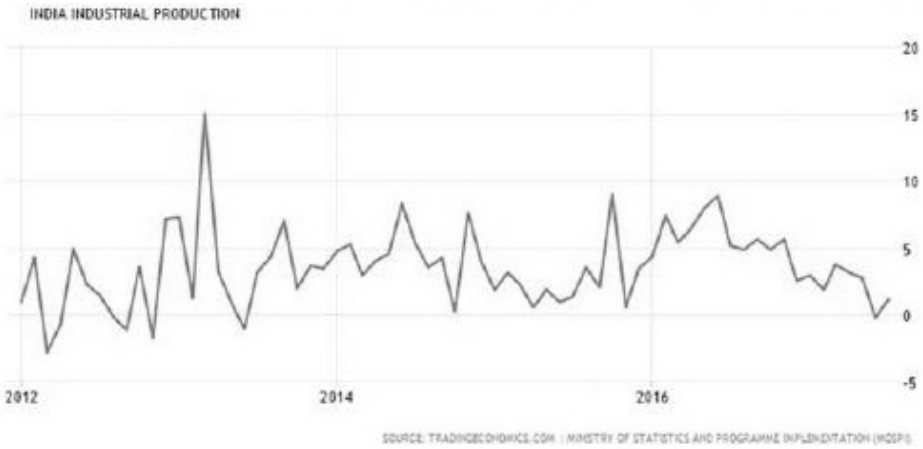


Figure 7: Growth in manufacturing production %

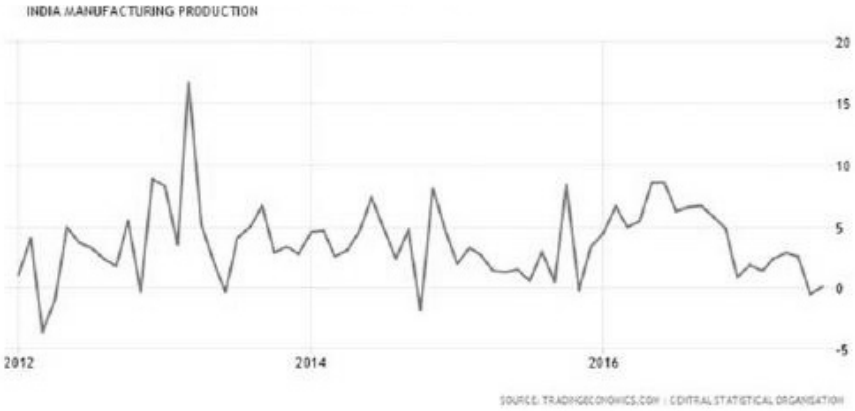
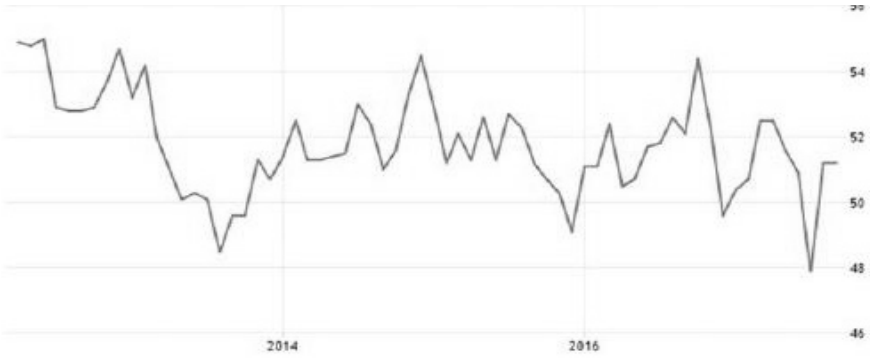


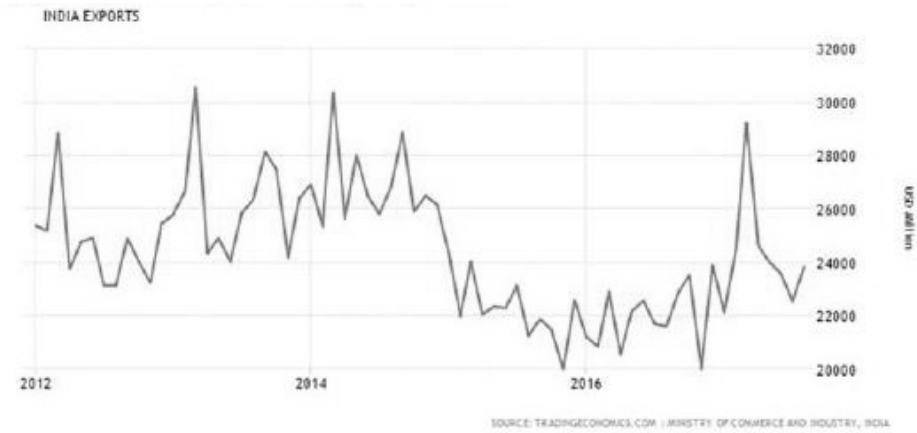
Figure 8: India Purchasing Manager's Index



Source: Markit Economics

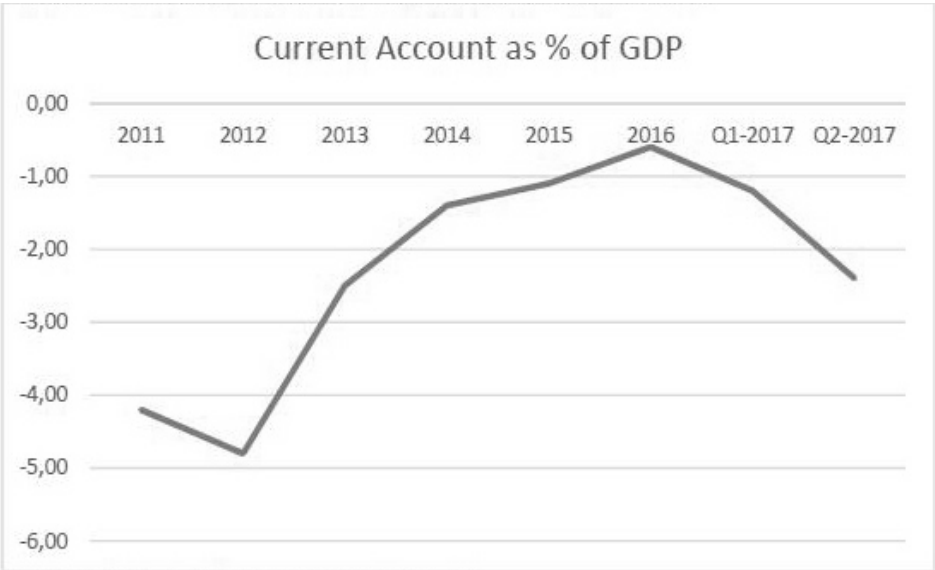
This downward trend has been manifested in exports of manufactured goods as well (Figure 9). India's exports which were sliding steadily since 2014, showed an increase of 4.7 percent in 2016-17. However, that increase has stalled.

Figure 9: India Volume of Exports in USD Million



The current account after having declined consecutively for 4 years, has risen again in 2017 on the back of a higher imports manufacturing (Figure 10).

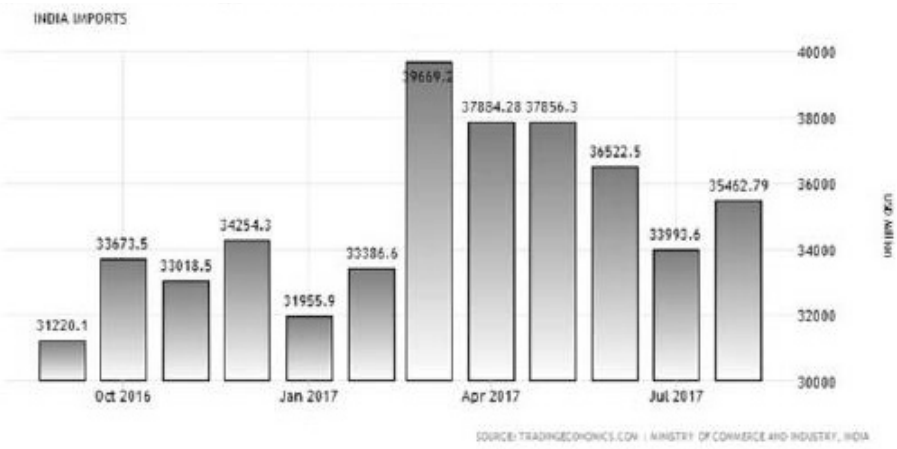
Figure 10: India's current account deficit as percentage of GDP



Source: OECD stat, extracted 25 September 2017.

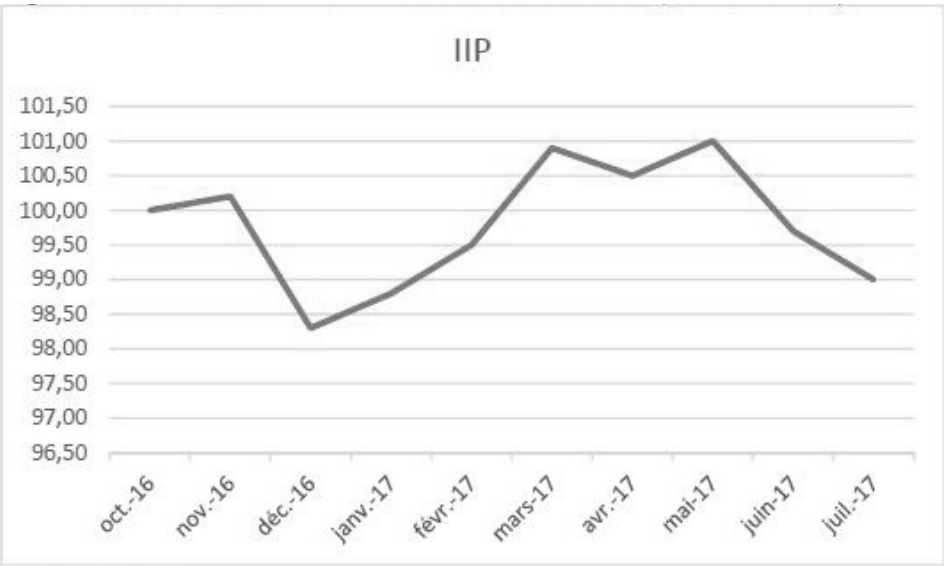
The downward trend in many of the economic variables has been unambiguous since the beginning of 2017. The output growth has slowed to 5.7 percent against the backdrop of demonetization and introduction of the GST. Imports to India jumped by 21 percent compared to the previous year in August 2017. In April-August 2017-18, imports climbed to 26.6 percent over the same period of 2016 (Figure 11).

Figure 11: India's imports since demonetisation (USD Millions)



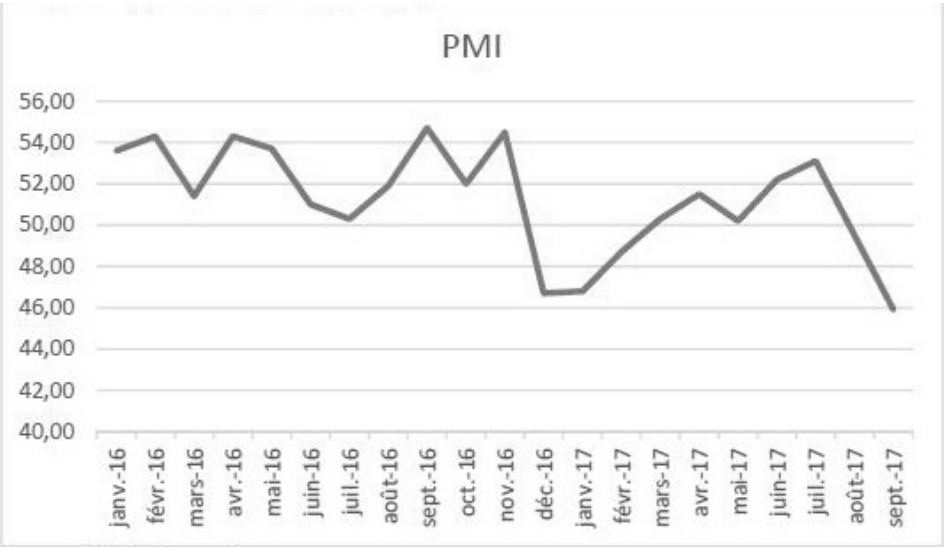
Stronger imports have affected GDP growth. Furthermore, as imports have surged, domestic production (IP, PMIs) has stumbled (Figures 12, 13). This suggests that domestic supply chains have potentially been disrupted in the manufacturing sector post-demonetization – likely to involve small and medium enterprises (SMEs) – and that activity has been replaced by imports, despite slowing domestic demand.

Figure 12: India's Index of Industrial Production 2016-17
(Oct 2016=100)



Source: MOSPI

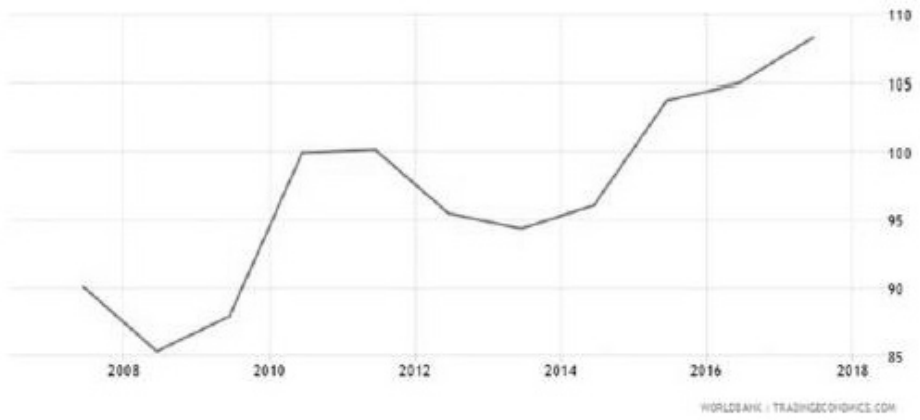
Figure 13: Purchasing Manager's Index



Source: Markit Economics

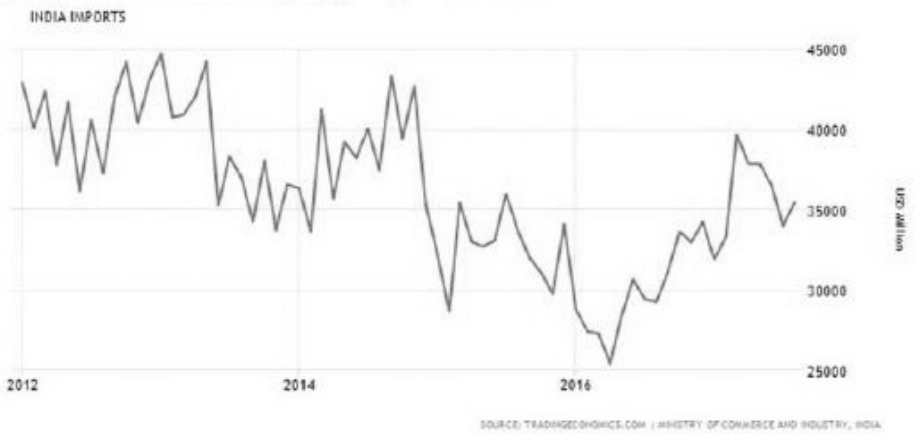
In addition, the economy has been suffering from the cumulative impact of an overvalued exchange rate that has adversely affected domestic production and has been sucking in imports (Figure 14).

Figure 14: India's real effective exchange rate (REER)



The introduction of GST in July 2017 has been beset by technical problems, undermining India's exports. Small and Medium Enterprises (SMEs) raised concerns about the compliance burden and difficulties in filing monthly returns while exporters have faced difficulties in securing tax refunds resulting in access to working capital (Wells & Thirlwall, 2003). This supply side disruption was inevitable after demonetization and GST, and the gap has been fulfilled by imports (Figure 15).

Figure 15: India volume of imports in USD Million



The challenge is in ensuring that this transitory phenomenon of increased imports does not become permanent. The cumulative effect of an overvalued currency, demonetization and the hurried implementation of GST may have exacerbated an enduring trend in the loss of India's competitiveness in production and exports of manufactured goods.

That loss of competitiveness in manufacturing is directly related to rigidity in the quality of, and access to, India's factor markets as well as several infrastructural and regulatory bottlenecks, resulting in considerable factor market misallocation and lower productivity.

CURRENT CHALLENGES FACING INDIA IN BECOMING A MANUFACTURING HUB

The success of the auto industry offers significant experience to Indian manufacturing, especially to advanced manufacturing sectors such as defense, aircraft, and ship building. The government has introduced significant policy changes to realize this objective and expand the experience of the auto industry. However, manufacturers still face significant hurdles. The majority of FDI, since *Make in India*'s inauguration, has been in the services sector, which attracted 60 percent of India's total FDI inflows from 2016 to 2017.Weak infrastructure has hindered the *Make in India* initiative. The futuristic *Smart Cities Mission*, set out to develop infrastructure, has not yet come to fruition in a way to stimulate growth in manufacturing. The requirements of high skilled people for the manufacturing sector are misaligned with the existing skill profile of India's young labor force. Regulations that have yet to be streamlined and a shallow supply chain ecosystem are additional challenges.

It is too early to call *Make in India* a success or a failure. Despite some significant policy changes, India still urgently needs to address a number of policy and practical implementation issues before investors shift their attention away from goods that are made in China for decades and towards 'Make in India'. The ten most important of these are discussed in detail below and include, *inter alia*:

- Reforming labor regulations to support enterprise growth
- Improving education and training
- Making land acquisition more efficient

- Reforming corporate and other taxation as it relates to manufacturing
- Making Bilateral Investment Treaties (BITs) more user friendly
- Improving and quickening regulatory approvals
- Removing infrastructure bottlenecks
- Dealing with high tariff and non-tariff barriers, and trade facilitation
- Dealing with the non-performing assets in public sector banks; and, finally
- Eliminating high levels of endemic corruption at central, state and local levels of government which continue to persist despite an ostensible anti-corruption stance.

Reforming labor regulations to support enterprise growth: Among reforms in factor markets, reforming labor laws is crucial for creating more jobs. Despite an abundance in unskilled labor, Indian firms have expanded largely in capital-intensive sectors (engineering goods, pharmaceuticals) or used excessively capital-intensive technologies in other sectors, resulting in low utilization of labor.

Labor laws which make firing (and therefore hiring) difficult also introduce other rigidities leading to increase in the cost of labor, thus incentivizing deployment of highly capital-intensive technologies. Regulating companies' ability to fire factory workers, especially for larger companies, led to many factories staying small to avoid increased regulatory burdens, while many others try to have their records show their workers as contract labor.

Labor market rigidities remain high because of the multiplicity of labor laws and high costs of meeting legal requirements. The Industrial Disputes Act (IDA) of 1947 is the basis of industrial labor regulations in India (it requires firms employing 100 workers or more to seek government's permission to dismiss a worker or to close a plant); firms are required to comply with numerous, complex and ambiguous laws governing different aspects of the labor market (such as laws governing minimum wages, resolution of industrial disputes, conditions for hiring and firing workers, and conditions for the closure of establishments etc.).

Labor market rigidities have resulted in a large informal (unorganized) sector which employs nearly 90 percent of the Indian workforce. Although the informal sector provides useful employment opportunities, the persistent high level of informality has failed to improve labor welfare (as workers operate in an unregulated environment, are paid low wages with no job security), negating the very motive of India's pro-worker regulations. The government has simplified administration of labor laws through an online portal called Shram Suvidha.

Although several initiatives have been taken at central and state government levels to reduce the detrimental effects of India's onerous and rigid labor regulations, significant reforms are needed to promote quality employment and reduce income inequality. These regulations protect the formal sector while increasing the size of the informal sector that evades them.

Reform of labor regulations should aim at providing a minimum floor of pay as well as adequate social and labor protection for all workers, irrespective of the status, size and activity of any firm. This would require introducing a comprehensive labor law which would consolidate and simplify existing regulations and reduce uncertainty surrounding regulations as well as compliance costs for companies. Legislative changes to bring about some significant labor reforms, like simplification of labor laws reducing the 44 labor laws into 4 codes, have been delayed. In the meantime, the responsibility for introducing labor reforms has been delegated to state governments.

Improving education and training: The average age of India's population by 2020 is projected to be the lowest in the world— around 29 whereas it is 37 in China and the United States of America, 45 in West Europe, and 48 in Japan. While the global economy is expected to witness a shortage in the young population by 2020 with around 56 million, India will be the only country with a youth surplus of 47 million.

India's demographic transition makes it imperative to ensure employment opportunities for millions of youth each year. Alongside employment, skill development is equally important as over the years jobs have become more skill-intensive with changes in technology as well as increased inter-linkages across economic activities.

India needs to equip 15 million people by 2020 with the skills necessary to realize Make in India's aim to bring more high-grade manufacturing to the country. The country, however, faces a big challenge ahead. It is estimated (per the latest survey by the Labor Bureau for 2013-14) that only 4.69 percent of persons aged 15 years and above have received or were receiving vocational training, of which only 2.8 percent was through formal channels while 4 percent was through the informal system (Szirmai & Bart, 2015).

The skill development issue in India is pertinent both at the demand and supply level. Generating employment is a challenge given the enormity of population entering the workforce each year. From the supply side, the issue is primarily related to employability of the workforce due to varying reasons ranging from poor education, lack of training facilities, inadequate skilling, quality issues leading to the mismatch of skill requirements, and poor perception of vocational skilling vis-à-vis formal education.

Aspiring Minds, an Indian employability assessment firm, has suggested in its 2016 report that more than 80 percent of engineers in India are "unemployable," after a study of about 150,000 engineering students in around 650 engineering colleges in the country. Workers trained in the vocational education and training system often require significant on-the-job training.

Given the lack of access to education and quality of education, continuing to improve access to education, especially at the secondary level, and improving the quality of education is imperative. As a step to raising quality, monitoring learning outcomes, tracking implementation and follow-up in monitoring the reforms is essential. India should collaborate closely with employers when designing vocational education and training programs to ensure that they are relevant to labor market needs.

Making land acquisition more efficient: India's new land law was designed to resolve one of the most vexing problems of state acquisition of agricultural land for industry, infrastructure and urban development. India's previous 1894 land acquisition law gave the state unchecked powers to take private land for projects deemed of public interest, including private investments. Private companies have mostly relied on state procured land

for big projects. However, these powers were widely abused, with farmers coerced into relinquishing land at throwaway prices usually to see the land resold afterwards for far more; with middlemen (usually local and state-level politicians) reaping windfall profits. This exploitation, and lack of alternative livelihoods, led to fierce resistance.

To address the land acquisition issue, Parliament passed the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Bill in 2013. It took effect in 2014, offering a fairer, more transparent process that protects the interests of land sellers and land seekers, thus facilitating land acquisition deals. While the new Land Acquisition Bill will increase the direct cost of land acquisition, it is also expected to reduce the indirect costs as the incidence of disputes and litigation should decline.

Still, the process of acquiring land may be long and fraught. Land ownership still remains opaque, and re-zoning, from agricultural to industrial zones, has been fraught with risks and delays. Implementation of the law in practice needs to be more flexible and closely monitored; the weaknesses should be amended as needed. The government urgently needs to review the timelines established by the Bill and aim to make land acquisition faster. The institutional set-up should allow for swift resolution of disputes.

The government introduced nine main amendments to the 2013 legislation through an ordinance in 2014, and subsequently as part of an amendment Bill in 2015. However, due to stiff opposition from various political parties, the government agreed to drop most of its amendments and reintroduced clauses related to consent of affected families and social impact assessments. Other amendments are now under the consideration of a joint parliamentary committee.

Reforming taxation: The World Bank ranks India 172nd out of 190 countries in 2017 in the "Ease of Paying Taxes". The overall effective tax rate for small to medium sized companies is relatively high. The indirect tax system is complex, costly to comply with and puts India's manufacturing sector at a competitive disadvantage in international markets.

The Goods and Services Tax (GST) which was introduced in July 2017, is expected to result in the dismantling of inter-state check posts, and to improve the domestic and international competitiveness of Indian manufacturing firms significantly. Simply halving the delays due to road blocks, tolls and other stoppages could cut freight times by 20-30 percent and logistics costs by an even higher amount, 30-40 percent. This alone can go a long way in boosting the competitiveness of India's key manufacturing sectors by 3 to 4 percent of net sales, thereby helping India return to a high growth path and enabling large scale job creation.

State border check-points, tasked primarily with carrying out compliance procedures for the diverse sales and entry tax requirements of different states, combined with other delays, keep trucks from moving during 60 percent of the entire end-to-end transit time. High variability and unpredictability in shipments add to total logistics costs in the form of higher-than-optimal buffer stocks and lost sales, pushing logistics costs in India 2-3 times more than those of international benchmarks (Chakravarty & Mitra, 2009).

The corporate income tax (CIT) system in India is characterized by high effective tax rates and a narrow tax base. High effective tax rates result from the imposition of several charges on top of an already significant statutory CIT rate, together with a corporate-level tax on distributed dividends (the dividend distribution tax). Even after the proposed reduction in the statutory CIT rate, effective tax rates for equity-financed investment will remain high, discouraging such investment. For example, average effective tax rates for an equity-financed investment range from 37.8 percent to 44.8 percent depending on asset type, while marginal effective tax rates range from 24.3 percent to 52.7 percent (Kathuria,& Rajesh, 2013).

The corporate tax base is narrow due to a wide range of tax concessions, while multinational enterprises are also able to minimize their tax liability in India by exploiting mismatches in international tax rules. These concessions result in some corporations paying significantly less tax than the high effective tax rates imply (Baumol, 1967).

Total gross corporate income tax concessions are estimated at INR 984 billion (Rodrik, 2016). This equates to 21.8 percent of CIT revenue (0.8 percent of GDP) in 2014-15. In addition to the loss in tax revenue, the effectiveness of such concessions in achieving their policy goals is often mixed and the concessions are relatively complex leading to costly disputes over eligibility, facilitating outright abuse. The overall business tax base is narrowed by a high degree of informality amongst small businesses.

To reduce the relatively high statutory CIT rate and broaden the narrow corporate tax base as compared to other major economies, the government announced in its 2015 budget that it would undertake CIT reform. Over four years from 2016, the government has proposed to reduce the statutory CIT rate (for resident corporations) from 30 percent to 25 percent. In addition, the government has proposed "rationalization and removal of various kinds of tax exemptions".

Meanwhile, apart from the complexity of the Indian tax system which complicates its interpretation and leaves too much to official discretion, an aggressive audit process and frequent changes in tax laws with retrospective effect have also undermined economic activity and resulted in India leading the world in numbers of tax disputes (OECD, 2014).

CBDT data show that in 2012-13, India had over 381,000 tax disputes. In particular, the implementation of retrospective legislation on the taxation of indirect transfers of assets, and tax administration rulings regarding the application of MAT (minimum alternative tax) to foreign institutional investors have been particularly damaging.

However, the recent introduction of an advance pricing agreement (APA) regime has increased business certainty for multinationals. The Easwar Committee was set up in 2015 to identify parts of the Income Tax Act that are unclear and lead to unnecessary disputes. It reported its findings in early 2016 and the government is currently considering its recommendations. Nevertheless, issues remain regarding the audit processes and transfer pricing rules (Anand, Kalpana & Saurabh, 2015).

Bilateral Investment Treaties (BITs): Since 1994, India had signed 84 BITs with countries such as the UK, France, Germany, Australia, China, Malaysia, Thailand, Mexico, Russia, Egypt, Saudi Arabia, the UAE, Turkey and others. Many of these BITs contained protection for investors (including commitments to fair and equitable treatment (FET), non-discrimination and most favored nation treatment (MFN), the ability to repatriate proceeds, and protection from expropriation. They also allowed for arbitration of alleged breaches of these protections directly between the investor and the host government.

However, in recent years, India has been facing several arbitration claims from investors under its BITs. This began with India losing a claim in 2011 that was brought by Australia alleging excessive judicial delays in enforcing a commercial arbitration award through the Indian courts. Further claims have since been brought on retrospective taxation, the allocation of satellite spectrum. In 2016, India was one of the most frequently-named respondent states in BIT proceedings (Mehrotra, 2017).

In early 2017, the government terminated bilateral investment treaties with 58 countries, including 22 EU countries. Many of these BITs ceased to apply to new investments from April 2017. For the remaining 26 of its BITs that have not completed their initial term, there is a proposed joint interpretative statement to the counterparties to align the ongoing treaties with the 2015 Model BIT. On the other hand, investments made before the termination of the 58 treaties may be protected for some years under the 'sunset' clauses in those BITs.

The new Model BIT contains more restrictive definitions of 'investor' and 'investment' and is intended to reduce the exposure of the Indian government to future claims, by excluding taxation measures from its domain and removing or qualifying the MFN and FET protections. The 2015 Model BIT preserves the mechanism for settlement of investor-state disputes by arbitration.

Until new arrangements are agreed between India and relevant counterparty states, new investments of foreign investors to be made in India and Indian investments to be made in the counterparty country will cease to receive BIT protections. The termination of BITs has sent mixed messages

at a time when the government is taking vital steps to attract inbound investment through Make in India and when the outbound investment by Indian companies continues to increase in both developed and developing economies (Goldar, 2016).

Regulatory Approvals: Foreign investment in India has always been heavily regulated, requiring approvals from various government ministries. As a result, the Foreign Investment Promotion Board (FIPB) was established in August 1991. Regulatory approvals have caused substantial delays in project implementation. There were multiple agencies involved and various approvals were required across different stages of the project cycle. Many of the guidelines evolved continuously (often whimsically) and are needed to be implemented, not only in new projects, but also in under-construction projects, which then had to comply with revised standards midway through their execution stage. Several approvals did not have defined timelines.

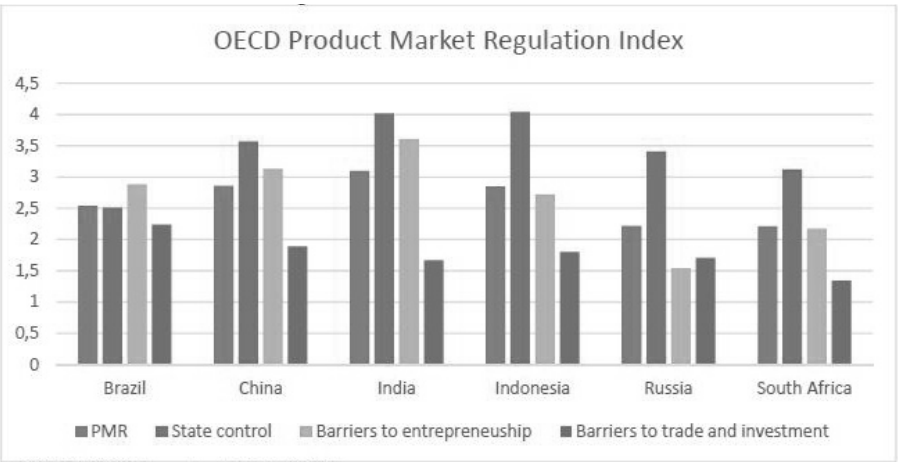
In 2017, the government decided to get away with the FIPB. Now, foreign investment in any of the 11 notified sectors requires approval only from the concerned administrative ministry. The Department of Industrial Policy and Promotion has issued a Standard Operating Procedure (SoP) for processing FDI proposals under this new regime. The most significant feature of this SoP is the time period of 8-10 weeks within which investment applications are required to be cleared by the ministries concerned.

However, there are fundamental problems in the current Indian legal institutional framework around FDI approvals. the primary law concerning foreign investment – the Foreign Exchange Management Act, 1999 (FEMA) – does not create any institutional accountability. It does not prescribe any time limits for the finance ministry to clear foreign investment applications. FEMA does not clarify the purpose of government approval itself. Further, the law does not require the government to give any reasons for rejecting an investment application.

The DIPP's new SoP does not resolve any of these fundamental issues. The timelines it imposes on the ministries for various actions are not binding. The SoP does not change the internal incentive structure of the bureaucracy to ensure that they comply with the timelines, leading to a lack of time-bound inter-ministerial coordination needed for the grant of approvals (the Goods and Service Tax Council (GST), 2017).

The OECD Product Market Regulation Index (PMR) (Figure 16) measures the extent of a growth enhancing competitive environment in a country and a level playing field among firms. The aggregate PMR indicator is the simple average across three indicators that are state control, barriers to entrepreneurship and barriers to trade and investment. OECD estimates suggest that reducing India's score on the OECD's product market regulation indicator by 20 percent could boost the level of productivity by around 2 percent over the next 5 years (FICCI & Konrad, 2015) (World Bank, 2014).

Figure 16: OECD Product Market Regulation Index



Source: OECD PMR Index, extracted 5 Oct 2017.

Infrastructure bottlenecks: In the last 20 years, although not as much as China, India has made substantial investments in infrastructure. In many areas, the investment and maintenance targets have not been met, leaving infrastructure in very poor condition. Firms in India face frequent power outages and transport infrastructure is below par.

Major new infrastructure investments are required because logistical bottlenecks need to be removed to lower the cost of doing business in India. The approach document for the 12th Five Year Plan (2012-17) projected a requirement of US$ 1 trillion for India's infrastructure development. Yet, infrastructure investment in India has been held back by poor governance, political challenges, lack of transparency in PPP bidding and awarding processes, delays in regulatory approvals and land clearances, lack of

availability of long term debt, taxation issues (provisions to tax indirect investments) and lack of independent regulatory authorities in each of the infrastructure sectors.

Infrastructure bottlenecks have contributed to longer lead times and excess inventory having to be held across the value chain. Poor supply chain performance and reliability is one of the reasons why many foreign companies use their Indian factories mainly to serve the domestic market and avoid integrating them into their global networks.

Lack of investment in physical infrastructure has hampered integration not just domestically (connecting more remote regions), but also regionally and internationally. Investment in the maintenance and upgrading of existing and new infrastructure could provide an important boost to economic activity.

Beyond connectivity issues, India faces the critical challenge of power shortages (Thomas, 2017), which impedes the smooth functioning of GVCs. Electricity supply in India is seen to be on par with Cambodia, the worst performer in SEA. In terms of logistics performance, India's performance stands between that of Thailand and Indonesia (OECD, 2017).

The government has taken several steps to promote the flow of long-term funds into infrastructure investment e.g. setting up Infrastructure Debt Funds, raising foreign institutional investor (FII) limits for infrastructure, and liberalizing external commercial borrowing (ECB) limits. India has also attracted private capital in recent years. Deepening bond markets by gradually relaxing the restrictions on domestic and foreign investors would expand financing.

High tariff and non-tariff barriers, trade facilitation: High import tariffs and non-tariff barriers also hinder the productivity and competitiveness of the manufacturing sector. Tariffs have been cut significantly since the early 1990s, yet tariffs remain high compared to other BRICs and OECD countries. India also imposes non-tariff barriers in the form of quantitative restrictions, import licensing, burdensome mandatory testing and certification for a large number of products.

In terms of trade facilitation, the World Bank (2010) has noted that for Nepal to trade goods with India, it takes around 200 signatures; while trading from India to Nepal requires around 140. At one important border between Bangladesh and India, trucks are often required to wait over four days in order to cross the border.

The OECD Trade Facilitation Indicators suggest that India performs better than the averages of Asian and lower-middle income countries in a number of areas including information availability, involvement of the trade community, advance rulings, appeal procedures and fees and charges (Figure 17). However, India could draw considerable benefits in terms of trade volumes and trade costs by streamlining border procedures.

Trade facilitation and better infrastructure are necessary, but are insufficient conditions for further value chain participation. These measures need to be complemented with MFN tariff liberalization and institutional reform. Efforts to this end could help attract foreign investment in new technologies complementary to India's labor abundance. In many respects, and particularly in terms of labor endowments, India resembles many South East Asian countries, and therefore should be able to attract important GVC activity, which may help further regional development objectives (MAT, 2014/2015).

Figure 17: OECD Trace Facilitation Indicators

Source: OECD, extracted 4 Oct 2017.
Note: The TFIs take values from 0 to 2, where 2 represents the best performance that can be achieved.

Non-performing assets in public sector banks: Corporate and banking sector vulnerabilities have had serious implications on the overall investment environment of the country. According to the 2016-17 Economic Survey, 57 percent of the top stressed debtors would require to reduce their debt levels by 75 percent to restore viability, suggesting that there is little capacity to raise funding for capital expenditure or to attract investors to turn the assets around.

The NPA problem of public sector banks is a deep structural sign of crony capitalism. To deal with the NPA problem the government has reformed insolvency laws by enacting the Insolvency and Bankruptcy Code in 2016 and made it operational soon. Until the Code, there was no single legislation that governed corporate insolvency and bankruptcy proceedings in India. The government has empowered the Reserve Bank of India (RBI) to force banks to resolve and restructure stressed assets by invoking the bankruptcy code against defaulters. The government has also consolidated one bank—the State Bank. However, these measures have failed to provide a comprehensive strategy of how the public sector banking can return to sustainability.

Moreover, in October 2017, the government agreed to recapitalize public sector banks by Rs. 2.11 trillion (equivalent to about 1.3 percent of GDP) between 2017-19 as banks undergo the resolution process through the new bankruptcy law. What is different about this recapitalization is that the government will issue Rs. 1.35 trillion as "recapitalization bonds" over the next two years. Along with this, recent steps to overhaul the bankruptcy laws have finally drawn a line under delinquent loans. It is expected that during 2018-19, the assets and debts of about 50 largest defaulters may be sold off by court-appointed professionals, in a process in which banks are likely to face losses of up to 60 percent on their loans.

Public sector banks have been used by political parties over the years to sustain political corruption and to implement government policies. The fight against corruption will be incomplete if it does not include policies to tackle the issues of corporate governance in public sector banks.

Corruption: India has been overwhelmed by endemic corruption in recent times. According to Transparency International's 2016 Corruption Perception Index, India ranks 79th, tied with China, among 176 countries. Corruption has acted as a non-transparent tax on India's growth leading to higher costs and delays. Corruption is especially prevalent in the judiciary, police, tax, public services and public procurement sectors.

Due to varying levels of corruption and the poor quality of government operations across India, local investment conditions vary between and within states. The Prevention of Corruption Act is the principal legal framework that focuses on corruption in the public sector. Both active and passive bribery are covered by this legislation, and public officials are only allowed to accept gifts of nominal value.

Due to low levels of enforcement and monitoring however, integrity in state bodies is lacking, and corrupt practices such as facilitation payments and bribes persist. Significant reasons most frequently put forward for the level of corruption in India are its public and corporate governance regimes. The new Companies Act, enacted in 2013, is seen as important in improving the ease and efficiency of doing business in India. It deals with strengthening of the internal controls through corporate governance, corporate social responsibility, auditor rotation, and investor protection.

The New Act holds out the possibility of reducing the risk of corrupt practices. Despite the government has stepped up its efforts to counter corruption, red tape and bribery continue to be widespread.

CONCLUSION

Manufacturing has the potential to lift half a billion more of India's population out of poverty through income, export and employment growth. However, the contribution of manufacturing in India's economic activity has been declining steadily for the last ten years. Recently, demonetization, technical problems associated with the introduction of GST and an overvalued currency, have exacerbated an enduring trend in the loss of India's competitiveness in the production and the exports of manufactured goods.

Structural bottlenecks have long affected the manufacturing sector, more than the services sector. India's failure to industrialize is due to labor market legislation which puts a tariff on large-scale manufacturing establishments and the long and fraught process to acquire land for industrial or infrastructure projects. Firms often cannot find employees with the right skills and training. Power outages and poor infrastructure also make it difficult for firms to be competitive and reach new markets.

If India was successful in unlocking its factor markets, especially land and labor for manufacturing, domestic and global corporations will accelerate the transformation. Unfortunately, the half measures taken to unlock land and labor have included passing the responsibility to regional governments, anticipating strong resistance from trade unions and caste lobbies.

In 2015, the government failed to repeal and replace the Land Acquisition Act of the previous government. That experience early in its term has resulted in the government proceeding cautiously in getting vital legislation passed. Despite the frequent assertion of nationalism, decisions on rational economic policies give precedence to the most divisive local interests, show weakness in face of mass defiance and show the government's inability to break the trade-off between alleviating a problem and tackling it.

Despite the government's inclination, the introduction of the GST is a significant reform which establishes a single market in goods and services with a uniform indirect tax structure. The fact that it has taken 15 years to pass the legislation on GST is an indictment of India's corrosive politics. However, GST was compromised by poor design and implementation; with far too many rates over-complicating the regime, creating goods classification problems and imposing administrative burdens. The teething problems are much larger and therefore will take much longer to resolve.

There is no disagreement over why India has been steadily losing its competitiveness in manufacturing. Addressing structural bottlenecks, in particular rigid labor laws, inadequate investment in human capital, difficult process of land acquisition, regulation, and access to funding has been constrained by India's political compunctions.

Consequently, the progress that India has made in driving forward its *Make in India* initiative is confined largely to processes related to the ease of doing business, trade facilitation, and easing statutory restrictions on foreign direct investment across sectors.

For the *Make in India* initiative to have any realistic chance of any significant success, India urgently needs to address its more fundamental structural bottlenecks. Notwithstanding the dynamic marketing and exhortative campaigns for driving the *Make in India* initiative, achieving its objectives has remained daunting from the outset. It will continue to be challenging, given the serious structural and policy-reform deficits that remain to be addressed. In addition, the campaign – which relies too heavily on marketing and not enough on policy-product development -- has created expectations that cannot be met easily.

REFERENCES

[1] With $2.3 trillion in GDP, India is the world's ninth-largest economy and the third largest by purchasing power parity at $8 trillion (World Bank).

[2] ILO (2016). 'India Labor Market Update.' ILO Country Office for India.

[3] Dhawan, Rajat, Gautam Swaroop, and Adil Zainulbhai (2012). Fulfilling the promise of India's manufacturing sector. McKinsey and Company.

[4] Kaldor, N. 1967.Strategic Factors in Economic Development. Ithaca, NY: Cornell University.

[5] Thirlwall A.P. 1983. A Plain Man's Guide to Kaldor's Growth Laws. *Journal of Post Keynesian Economics* 5: 345–358.

[6] World Bank, Commission on Growth and Development. 2008. *The growth report: strategies for sustained growth and inclusive development.*

[7] Dasgupta S. & Singh A. 2005. Will Services be the New Engine of Indian Economic Growth? *Development and Change* 36: 1035–57.

[8] Wells H. & Thirlwall A.P. 2003. Testing Kaldor's Growth Laws across the Countries of Africa. *African Development Review* 15: 89–105.

[9] Szirmai, Adam and Bart Verspagen. 2015. "Manufacturing and Economic Growth in Developing Countries, 1950-2005." Structural Change and Economic Dynamics 34: 46-59.

[10] Chakravarty, S. and A. Mitra (2009), Is Industry still the engine of growth? An econometric study of the organized sector employment in India, Journal *of Policy Modeling* 31, 22-35.

[11] Kathuria, Vinish and Rajesh R. Natarajan. 2013. "Is Manufacturing an Engine of Growth in India in the Post-Nineties?" Journal of South Asian Development 8(3): 385-408.

[12] Baumol, William J. 1967. "Macroeconomics of Unbalanced Growth: The Anatomy of Urban Crisis." *American Economic Review* 57 (3): 415–26.

[13] Rodrik, Dani. 2016. "Premature Deindustrialization." *Journal of Economic Growth* 21: 1–33.

[14] OECD (2014a). Economic Survey of India.

[15] Anand, Rahul, Kalpana Kochhar and Saurabh Mishra (2015), "Make in India: Which Exports Can Drive the Next Wave of Growth?" IMF Working Paper No. 15/119

[16] Excessive imports have affected Indian manufacturing for the last 12-15 years. This is due to higher duties on intermediate goods compared to final finished goods, with the latter often enjoying concessional customs duty. This inverted duty structure has resulted in higher raw material cost at home. FICCI has pointed in a 2014 study the issue of inverted duties for sectors like aluminium, steel, chemicals, capital goods, electronics (Mehrotra, 2017).

[17] Goldar, Bishwanath (2016). Manufacturing growth in India in recent years: Is it getting overstated in India's new GDP series? Indian Growth and Development Review, 9 (2), 102-113.

[18] In response to the difficulties faced by the SMEs and exporters, the Goods and Service Tax (GST) Council in October 2017 introduced measures to ease the compliance burden of SMEs and access to funding for exporters.

[19] FICCI and Konrad Adenauer Stiftung (2015). Skills development in India.

[20] World Bank (2014). India development update.

[21] Thomas et al. (2017). Taxation and investment in India. OECD Economics Department Working Papers, No. 1397.

[22] OECD (2017). Economic Survey of India.

[23] The minimum alternate tax (MAT) was estimated to claw back INR 360 billion in 2014-15, reducing the total revenue forgone to INR 624 billion.

[24] OECD (2017). Economic Survey of India.

[25] Ibid.

[26] Peacock and Joseph (2017). Mixed messages to investors as India quietly terminates bilateral investment treaties with 58 countries. Herbert Smith Freehills Arbitration notes.

[27] Ibid.

[28] Datta, Pratik, Radhika Pandey and Sumant Prashant (2017). Replacing FIPB with Standard Operating Procedure not enough. https://ajayshahblog.blogspot.fr

[29] OECD (2014b). Improving the business environment through effective regulation. OECD India Policy Brief.

[30] Koske, I., I. Wanner, R. Bitetti and O. Barbiero (2015). The 2013 update of the OECD product market regulation indicators: policy insights for OECD and non-OECD countries. OECD Economics Department Working Papers, No. 1200.

[31] Ahmed, S., S. Kelegama and E. Ghani (eds.) (2010). Promoting Economic Cooperation in South Asia. World Bank.

[32] OECD (2015). The Participation of Developing Countries in Global Value Chains: Implications for Trade and Trade-Related Policies.

[33] Ibid.