

India Unconstrained A Guide for Investors

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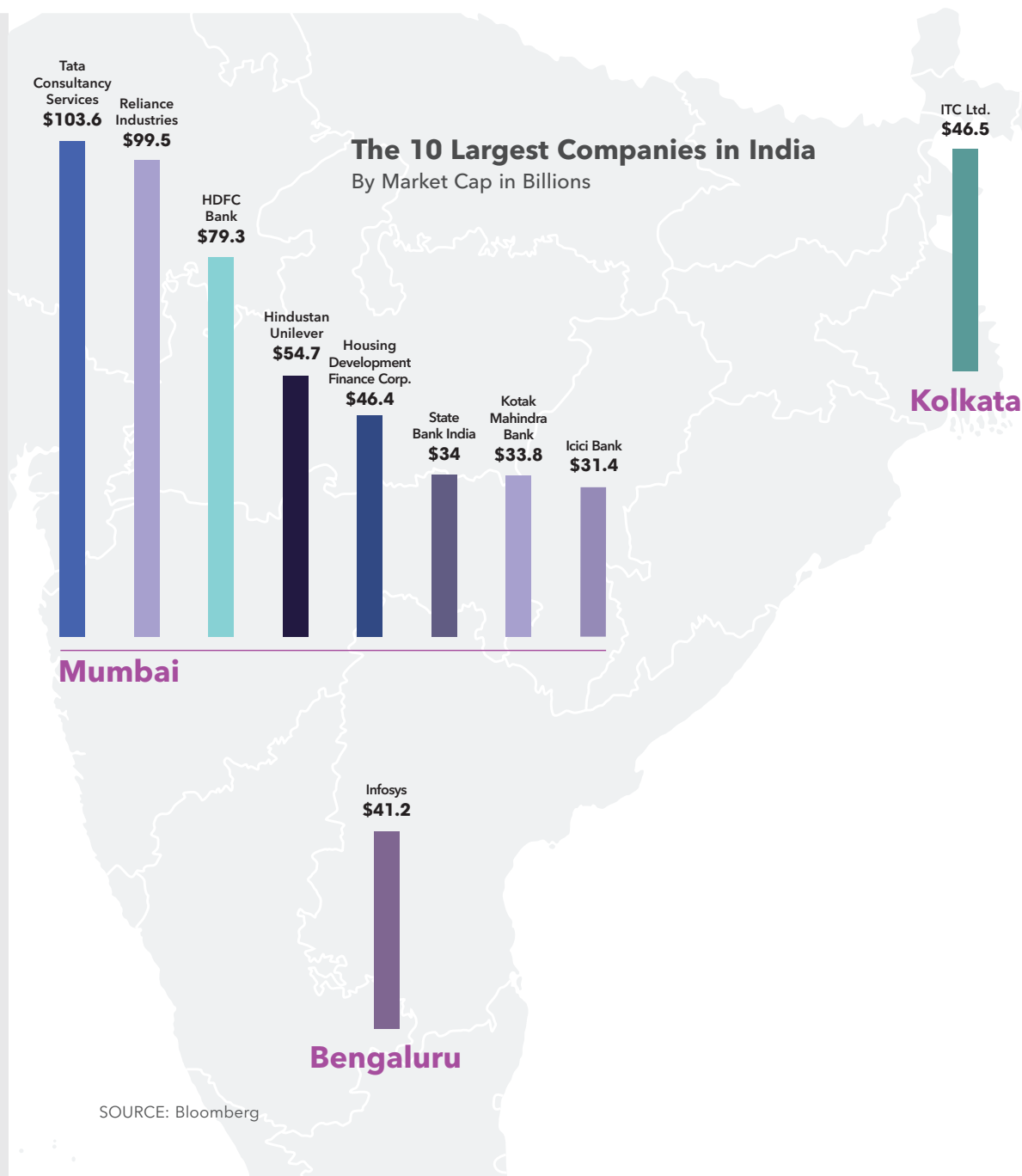
A SUBCONTINENT AS NATION

On Nov. 8, 2016, the same day as the U.S. presidential election, Prime Minister of India Narendra Modi held an unscheduled live national television broadcast at 8:15 p.m. In his address to the nation, Modi declared that all Rupee 500 (approximately \$7) and Rupee 1,000 (\$14) banknotes would no longer be valid legal tender for transactions, effective at midnight that same day.

Thus, in one fell swoop, the government of India removed a major fraction—more than 85 percent by value—of its paper currency in circulation, as a measure to counter systemic graft and tax evasion in the country. What happened on Nov. 8 is in many ways emblematic of India's economic trajectory, which has progressed in fits and starts since India's independence from British rule in 1947.

India is a vast country with a population of more than 1.3 billion, the second-largest in the world. At the rate at which it is growing, India is expected to become the world's most populous nation by 2024, according to projections from the United Nations.

India's vastness is reflected in the tremendous diversity of its regional languages, ethnicities and religions. India is a federal union consisting of 29 states and seven union territories, with 22 officially recognized languages; some are part of the Indo-European group, to which Spanish and English also belong. Others are part of the Dravidian language group, which is believed to be indigenous to India and is spoken predominantly in South India. For this reason, India has two distinct film industries functioning in different languages—one for the north, centered in Mumbai, and one for the south—just one example of the kaleidoscopic nature of the country.



DISUNITY IN DIVERSITY

India is often referred to as the world's most populous democracy. The country has a bicameral parliamentary government, with the prime minister at the head of the executive branch, which makes him the most powerful official in the land. Unlike the United States, which effectively has a two-party system, India has a multiparty political equation, where smaller parties, often organized along regional or ideological lines, must form coalitions to reach a parliamentary majority. The prime minister serves as long as he or she commands the support of such a majority. But the splintered and often fractious nature of these coalitions means that the parliamentary status quo is easily shaken. As a result, of India's 14 prime ministers serving since independence in 1947, only five have remained for their full five-year term.

The nature of the country's political system is also reflected in its tax code, regulatory system and fiscal dynamic. Doing business in India is subject to a high degree of bureaucracy and red tape, as each state has its own set of rules that companies must abide by, which makes interstate commerce cumbersome.

The amount of red tape has historically led to a culture of graft at every governmental level, which has been India's developmental Achilles' heel. Dissatisfaction with governmental bureaucracy and services also means that the country has historically suffered from rampant tax evasion.

And so, the government decided to invalidate much of India's paper currency in 2016. Doing so dealt a sharp blow to India's cash economy—the facilitator of systemic graft and tax evasion.

The business climate continues to rapidly improve in India. The World Bank's Doing Business Report 2019 ranks India 77th on its "ease of doing business" index, a sharp improvement from its rankings in 2017 (100th) and 2016 (130th).



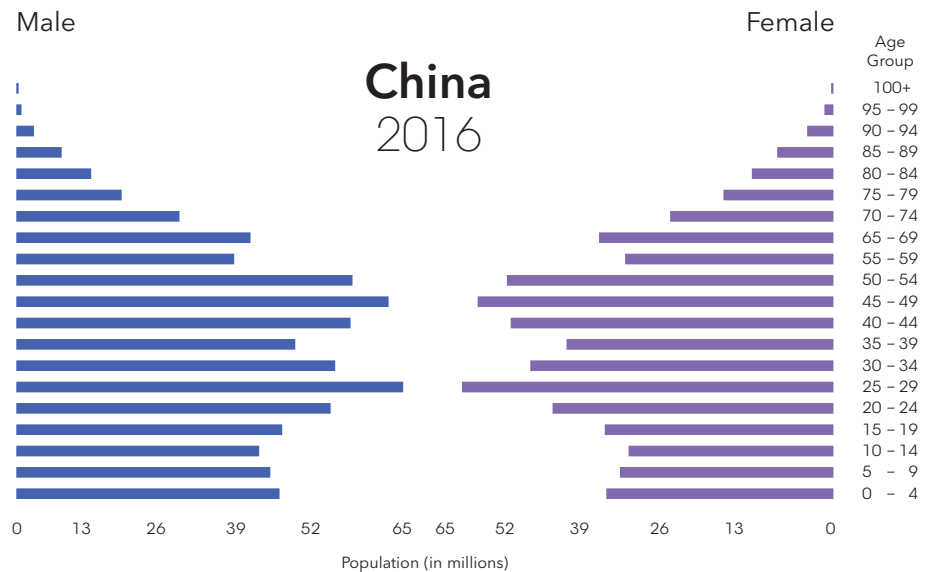
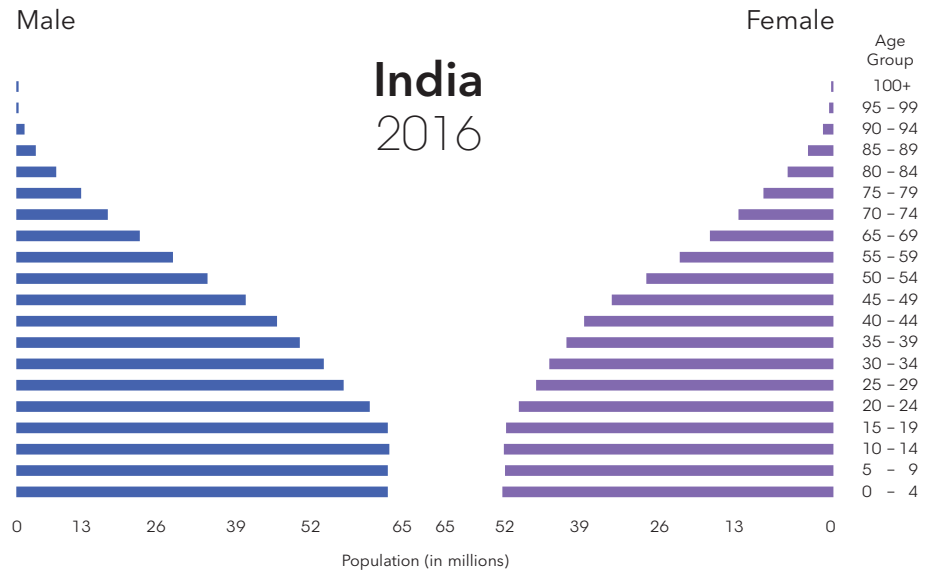
Central Mumbai, India

IMPEDIMENTS AND OPPORTUNITIES

The list of India's structural deficiencies is long. Of the major emerging economies, India has the highest ratio of government debt to GDP, at 70 percent (second only to Brazil). The country also has among the worst government fiscal balances, at negative 7 percent of GDP (third after Brazil and Saudi Arabia). Of the world's 4.2 billion people without affordable access to the internet, 1.1 billion reside in India. The country is a major net importer of energy, and runs a current account deficit of 2 percent of GDP. According to the World Economic Forum's 2017-2018 Global Competitiveness Report, India ranks 66th out of 137 nations globally in Infrastructure, and 91st in Health and Primary Education.

However, India's potential is as momentous as its shortfalls. The country's GDP is only \$2.597 trillion—a fraction of China's \$12.238 trillion. Only a decade ago, the two countries were much closer in economic standing, but while China has blazed ahead, India has fallen substantially behind. However, India has a demographic profile that most countries would aspire to. The median age in India is 28 years, and 45 percent of the population is under 25 years of age, which should constitute an able and productive workforce for decades to come. China, by comparison, largely due to its one-child policy that ended in 2016, is a more aged society, with a median age of 38 years.

Infrastructure development is perhaps the lowest-hanging fruit in India's economic saga. In this area, India has made some firm strides in recent years.



BREAKING THE MOLD

India's economic trajectory over the past few years has been linked to the ascendancy of Narendra Modi to the office of prime minister. In the 2014 general election, Modi's Bharatiya Janata Party (BJP) won a clean majority in the Lok Sabha, India's lower and more powerful house of parliament—the first time since 1984 that a party had won such a definitive majority. Therefore, Modi has had an unambiguous mandate from the people of India to rule and to push through his favored policy measures.

In addition to the aforementioned "demonetization" action in 2016, Modi's other big initiative has been to reform India's complex and archaic tax system. This historical tax system, which includes more than 17 different levies, has been largely responsible for drastically slowing interstate commerce and miring Indian businesses in bookkeeping hell. All of that has now been replaced with the single Goods and Services Tax (GST). In the month after its introduction, more than 1 million businesses registered with India's online GST portal.

Analogous to India's harmonization of the tax system through the GST is the nationwide rollout of the Aadhaar national identity scheme. With more than a billion people, many of whom are uneducated rural residents, simply taking stock of the country's human capital is a major challenge. The Aadhaar system provides each Indian citizen with a unique 12-digit identification number, linked to each individual's demographic and biometric information (iris and fingerprint scans). First launched in 2009, the program now covers the vast majority of India's population, with over 1.2 billion enrollees. Therefore, in scale and technological complexity, Aadhaar is unique, and stands apart as the only non-U.S. system globally to exceed 1 billion users, and the only one to have been developed in the public sector.

Building on the capabilities of the Aadhaar system, the Modi government has also launched a financial inclusion program, the Pradhan Mantri Jan Dhan Yojana ("Jan Dhan"), roughly translated



as the "Prime Minister's People's Wealth Scheme." One of the great tragedies of the Indian economy is its great number of poor, mostly unbanked individuals with little stake in the country's financial system. The Jan Dhan plan aims to remedy this; by creating paperless, no-frills, no-fee bank accounts, linked to citizens' Aadhaar identification numbers, the government has brought more than 300 million households into the modern financial age. In fact, on the first day that the Jan Dhan plan was launched, more than 10 million bank accounts were created.

In this way, through the GST, Aadhaar and Jan Dhan, the government has taken herculean steps toward building the apparatus for a dynamic 21st-century digital economy that is inclusive of all citizens.

Prime Minister
Narendra Modi
speaks at the
Singapore FinTech
Festival

THE WORLD'S GROWTH ENGINE

According to the World Bank, India now generates the world's sixth-largest GDP. Having laid much of the groundwork for economic reform, and given the long growth trajectory ahead of it, India is now poised to realize perhaps several decades of 5+ percent GDP growth. The McKinsey Global Institute estimates that India will be the third-largest incremental growth engine for the world economy by 2030.

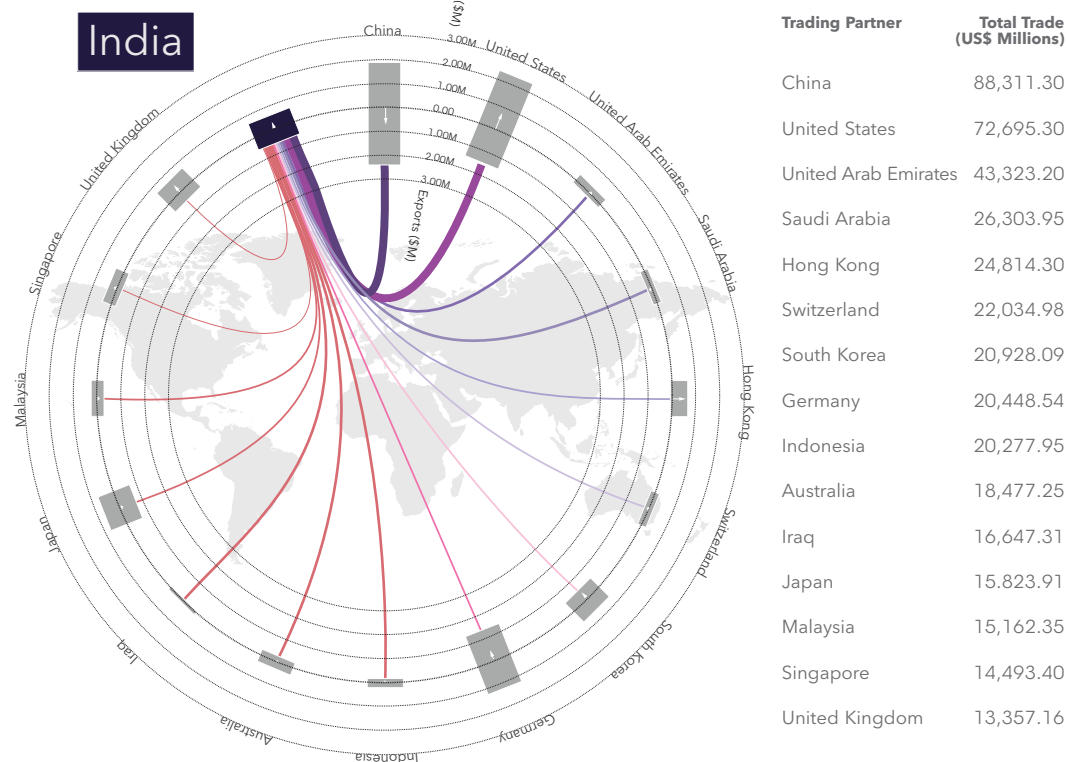
However, realizing India's nascent potential will require careful and diligent maneuvering. Thus far, many of the economic gains in the country have come from the information technology sector, which has earned a leading role on the world stage. But the spoils of the IT sector are concentrated among the wealthier segments of society and those with the educational background to participate in high-tech knowledge work. What India still lacks is a broad-based manufacturing base, of the kind that China has achieved. This is India's great economic challenge going forward, particularly as it relates to raising a large swath of its population out of poverty, as China has.

In addition to competing in the global economy, India must also look inward and focus on developing demand for domestic consumption. There is much low-hanging fruit here, as well, since India's urbanization ratio and GDP per capita still trail substantially behind those of China.

Perhaps the deciding factor in India's economic future will be the upcoming general election in 2019. Renewal of the Modi regime will likely be hailed positively, as it will provide continuity of vision and implementation. However, when it comes to India's political calculus, what actually will come to pass is anyone's guess.

By Chetan Jindal for Bloomberg Media Studios

Bloomberg World Trade Flow:



SOURCE: Bloomberg

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