

# INDIA DEVELOPMENT UPDATE

*India's trade opportunities in a changing global context*



## Preface

The India Development Update (IDU) summarizes recent developments in India's economy and places them in a medium-term and global context.

The report was prepared by a team led by Ran Li and Dhruv Sharma, under the guidance of Auguste Tano Kouame, Mathew Verghis, and Hoon Sahib Soh. Nora Dihel and Abhishek Anand wrote the special focus section. Core team members included Aurélien Kruse, Tanvir Malik, Abhishek Anand, Kanika Bhatnagar, Mohini Gupta, Kavya Singh, Nishtha Kochhar, Naresh Kumar, Nandini Krishnan, Venkat Bhargav Sreedhara, and Ileana Cristina Constantinescu.

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To receive the IDU and related publications by email, please email [mbaruah@worldbank.org](mailto:mbaruah@worldbank.org).  
For questions and comments, please email [ranli@worldbank.org](mailto:ranli@worldbank.org)

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# 1. Executive Summary

## **The global economy has been resilient but remains weak**

Global growth softened to 2.6 percent year-on-year (y-o-y) in 2023<sup>1</sup> but was higher than previously expected in the October 2023 India Development Update (IDU). Several major economies outperformed expectations, including the United States and Saudi Arabia. Inflationary pressures abated somewhat, and there was a notable downturn in global commodity prices. However, monetary policy remained relatively restrictive and geopolitical tensions persisted. Global growth is estimated to remain muted at 2.6 percent in 2024, significantly below pre-COVID levels.

## **India remained the fastest growing major economy**

In India, economic growth increased from 7.0 percent in FY22/23 (April 2022-March 2023) to 8.2 percent y-o-y in FY23/24. On the demand side, growth was primarily driven by a significant expansion of investment, in particular public infrastructure investment and private investment in real estate. On the supply side, it was supported by a rebound in the manufacturing sector, benefitting from a buoyant construction sector and low input costs.

## **Rapid growth was accompanied by improvement in the urban labor market**

The urban labor market improved between January and December 2023, particularly for women and youth. In Q3 FY23/24, the urban unemployment rate declined to its lowest levels since Q2 FY17/18, although youth unemployment remained high at 16.5 percent. Meanwhile, the urban worker population, as a share of the total urban population, increased for all groups (male, female and youth), reflecting the economy's growing capacity to absorb labor in the post-pandemic period.

## **The RBI maintained its policy rate**

Inflation remained within the Reserve Bank of India's (RBI) tolerance range throughout the fiscal year, except for a temporary spike in July-August 2023 driven by an uptick in food prices. Headline inflation declined steadily from 6.7 percent on average in FY22/23 to 5.4 percent in FY23/24. It moderated to 3.5 percent in July 2024. Meanwhile, core inflation fell to a record low of 3.0 percent in May 2024, before picking up slightly to 3.4 percent in July. To keep inflation within the tolerance range while enabling growth, the Monetary Policy Committee (MPC) of the RBI maintained its "withdrawal of accommodation" stance and kept the policy rate unchanged at 6.5 percent in its August 2024 meeting.

## **The current account deficit narrowed in FY23/24**

India's current account deficit (CAD) narrowed significantly in FY23/24, from 2.0 percent in the previous fiscal year to 0.7 percent of GDP. The improvement was driven by a decrease in the merchandise trade deficit, thanks to the decline in global oil prices and strong export growth (particularly electronics, iron ore, and pharmaceuticals). Services exports also continued to grow robustly. Foreign Portfolio Investment (FPIs) inflows were significant, offsetting a moderation in Foreign Direct Investment (FDI). The stability of the rupee against the US dollar and the appreciation of the nominal effective exchange rate (NEER) reflected the country's relatively positive economic outlook, robust portfolio inflows and substantial foreign exchange reserves.

## **The general government fiscal deficit narrowed in FY23/24, despite an increase in capital expenditure**

The general government fiscal deficit declined to 8.5 percent of GDP in FY23/24. The central government's fiscal deficit is estimated to have narrowed to 5.6 percent of GDP, down from 6.4 percent in the previous year. Revenue growth drove the improvement, particularly personal and corporate income taxes. While capital spending by the center surged by 28 percent, current expenditure grew by only 1.2 percent (below nominal GDP growth), helping to lower overall expenditure as a share of GDP. The states' combined

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<sup>1</sup> World Bank Global Economic Prospect, June 2024.

fiscal deficit is estimated to have expanded slightly in FY23/24 from FY22/23 at 2.9 percent of GDP, driven by increased capital expenditure. Public debt increased to 83.9 percent of GDP in FY23/24, from 82.5 percent in FY22/23, on account of the relatively low nominal rate of growth.

**The medium-term economic outlook is positive, despite global headwinds**

Growth is expected to remain strong at 7.0 percent in FY24/25, despite a subdued external environment, and the dissipation of post-pandemic rebound effects. External risks to the outlook are significant. In particular, geopolitical tensions could put pressure on commodity prices and critical supply chains, and resurgent inflation could still keep global interest rates “higher for longer”. These risks notwithstanding, medium-term prospects are positive. The significant expansion of public investment in recent years should crowd in corporate investments and a recovery of agriculture and declining inflation should boost private consumption growth. Under this baseline scenario, robust growth and declining inflation are expected to reduce extreme and moderate poverty.

**Fiscal consolidation is expected to continue and help lower public debt-to-GDP**

The overall fiscal deficit is projected to continue to fall, helping to reduce public debt gradually. The budget for FY24/25 targets a further consolidation of the central fiscal deficit from 5.6 percent in FY23/24 to 4.9 percent in FY24/25, driven by a continued reduction of current spending as a share of GDP. Revenue growth is projected to remain robust, thanks to improved tax administration, strong corporate profits and the higher-than-expected RBI dividend. Growth in capital spending, at both central and state levels, should moderate gradually while remaining high. The debt-to-GDP ratio is projected to decline to around 82 percent by FY26/27.

**The current account deficit is expected to stabilize at around 1.5 percent of GDP**

The current account deficit is expected to remain at around 1-1.6 percent of GDP up to FY26/27, supported by robust services exports and a continued expansion of medium-and-high technology goods exports. It is expected to be adequately financed by foreign investment flows, and foreign exchange reserves will continue to provide ample cover against any adverse external development.

### *Special focus: India's trade opportunities in a changing global context*

**To reach its US\$1 trillion export target by 2030, India needs to diversify its exports**

India needs to diversify its exports and increase its participation in Global Value Chains (GVCs). Over the past decades, despite rapid overall economic growth, India's trade in goods and services has decreased as a percentage of GDP and India's participation in GVCs has fallen. Exports are also relatively concentrated in goods and services that tend not to be labor-intensive. As a result, trade-jobs linkages are not fully exploited. A key factor behind this decline is the increase in import tariffs on key intermediary inputs, which has raised production costs and made producers less competitive in international markets. To achieve its ambitious export target and maximize the job creation potential of trade, India must diversify its export basket and enter new markets. Participating more actively in GVCs is crucial for doing so, and it would also boost overall competitiveness in the domestic economy and attract greater foreign investment.

**India's trade policy stance features both liberalizing measures and rising protectionism**

India's current trade policy stance features both liberalizing measures and rising protectionism. The implementation of the National Logistics Policy and digital initiatives aimed at reducing logistics costs are proactive steps towards enhancing trade facilitation and competitiveness. However, a resurgence in protectionist measures, including increased tariff and non-tariff barriers, is restricting India's trade openness. Recent Free Trade Agreements (FTAs) with countries such as the United Arab Emirates (UAE) and Australia signify a move towards preferential agreements. However, India does not

participate in mega trade blocs, such as the Regional Comprehensive Economic Partnership (RCEP), despite potential benefits from broader trade cooperation<sup>2</sup>.

**India could consider reforms in three areas**

A focused strategy toward achieving the US\$1 trillion export target would include measures to (i) reduce trade costs further, (ii) lower trade barriers, and (iii) revisit FTAs and regional integration options:

1. **Reducing Trade Costs:** India has taking very positive steps and can still do much more to reduce trade costs and improve trade facilitation, by simplifying and increasing the transparency of customs procedures and reducing red tape.
2. **Lowering Trade Barriers:** Reducing tariff and non-tariff barriers, relaxing restrictions on services trade, and making trade policies more predictable are all essential to boosting export competitiveness. Additional supportive policies that help exporters access vital imported intermediate inputs would also be critical.
3. **Reevaluating FTAs and trade integration options:** India could continue pursuing FTAs with a focus on assessing their impact and adjusting the overall strategy as needed. The country could also reevaluate its approach to trade integration, including the options on RCEP.

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<sup>2</sup> Petri and Plummer, 2020

## 2. Recent Economic Developments

### a. Real sector and inflation

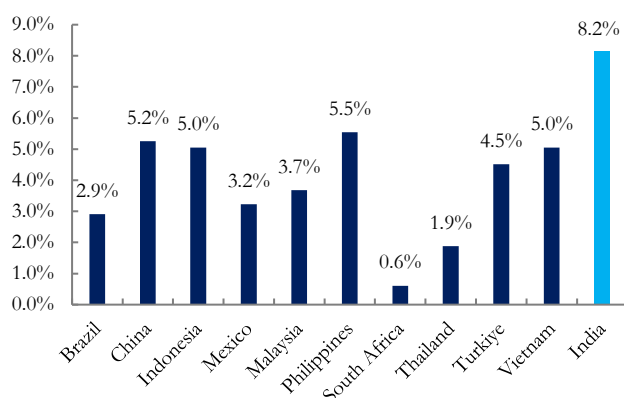
#### Growth & labor market

##### The global environment remained challenging in 2023

Global economic activity decelerated slightly in 2023, although less so than previously expected. Inflationary pressures moderated in major economies, and global commodity prices declined sharply. However, monetary policy remained relatively restrictive and geopolitical tensions persisted. FDI inflows to developing economies fell by 9 percent y-o-y in 2023, while global trade in goods and services was essentially flat (0.2 percent growth). A slump in China's property sector dampened its growth, while growth in other major developing economies remained stable but weak, with a few bright spots including India<sup>3</sup>.

**Figure 2.1: India is estimated to have been the fastest growing major economy in 2023**

(Real GDP growth, y-o-y percentage, 2023)



Source: Haver and World Bank staff calculations.

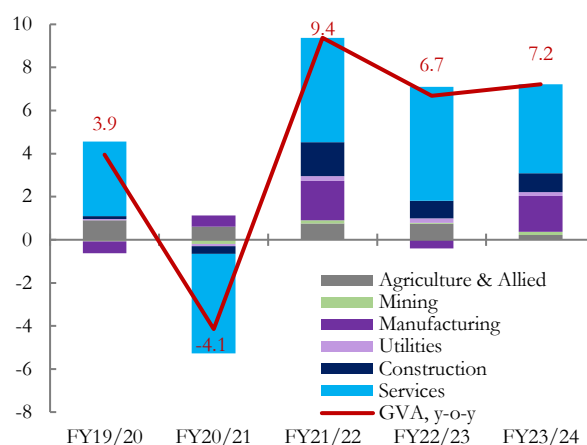
Note: For India, 2023 corresponds to FY23/24 (April 2023 – March 2024).

##### India's strong growth in FY23/24 was driven by a rebound in manufacturing...

India maintained its status as the world's fastest-growing major economy, with a real GDP growth rate of 8.2 percent in FY23/24 (Figure 2.1). Real Gross Value Added (GVA) grew by 7.2 percent, up from 6.7 percent in the previous year. On the supply side, growth was primarily driven by a rebound in manufacturing, which grew by 9.9 percent, after a contraction of 2.2 percent in FY22/23 (Figure 2.2). The manufacturing expansion was primarily supported by declining input costs<sup>4</sup>, as global oil prices moderated. By contrast, agriculture growth fell from 4.7 percent in FY22/23 to 1.4 percent in FY23/24, majorly due to below normal and uneven rainfall caused by El Nino in the second half (H2) of the fiscal year. Meanwhile, services growth remained robust (Figure 2.3), especially in modern services sectors (financial and professional services) (See Box 2.1).

**Figure 2.2: A rebound in manufacturing boosted real GVA growth in FY23/24**

(Contribution to GDP growth, percentage points, y-o-y)



Source: CEIC and World Bank staff calculations.

Note: For India, FY24 is the World Bank estimation.

<sup>3</sup> South Asia Development Update, April 2024: <https://www.worldbank.org/en/region/sar/publication/south-asia-development-update>

<sup>4</sup> Financial performance of manufacturing companies listed with stock exchanges and the monthly index of Industrial Production (IIP) (manufacturing) are used by CSO and MOSPI to compute the nominal manufacturing output in the absence of survey data from the annual survey of industries. ([https://mospi.gov.in/sites/default/files/press\\_releases\\_statements/Methodology\\_doc\\_for\\_compilation\\_of\\_Quarterly\\_GDP\\_28july17.pdf](https://mospi.gov.in/sites/default/files/press_releases_statements/Methodology_doc_for_compilation_of_Quarterly_GDP_28july17.pdf))



... as well as a significant contribution from net indirect taxes (NIT)

Net Indirect Taxes (NIT)<sup>5</sup>, or indirect taxes minus subsidies, increased sharply in FY23/24, by 19.1 percent y-o-y (compared to 10.6 percent in FY22/23). NIT contributed 1.0 percentage point to total real GDP growth (Figure 2.4) and resulted in an unusually large divergence between GVA and GDP growth. The increase in NIT was due to a substantial decrease in subsidies, as lower market costs of urea drove down fertilizer subsidy payouts.

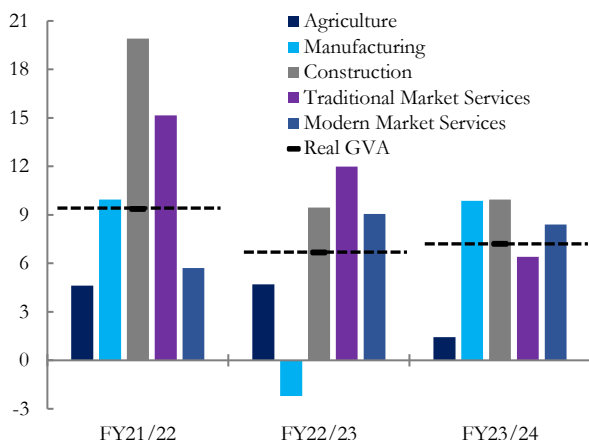
Expenditure-side GDP was bolstered by investment ...

Investment surged in FY23/24, fueled by public infrastructure development and a real estate upswing (Figure 2.5). Conversely, growth in private consumption, which accounts for around 60 percent of GDP, weakened significantly, as underperforming agriculture depressed rural incomes and post-pandemic pent-up demand waned. Government consumption also decelerated sharply in FY23/24, reflecting the central government's continued withdrawal of pandemic-related stimulus measures. Finally, net exports in real terms were a drag on growth<sup>6</sup> – withdrawing two percentage points from growth in FY23/24. Weak global growth and heightened geopolitical tensions dampened demand for merchandise exports, while imports surged (in real terms) due to strong domestic demand for oil and electronics.

... but the sizeable discrepancies obscured the picture

Variations in discrepancies<sup>7</sup> were significant in FY23/24 (Figure 2.6), leaving much of the demand-side growth unexplained. As a result, getting an accurate picture of individual drivers of growth on the demand side will be challenging, until the discrepancies are reduced in subsequent estimates.

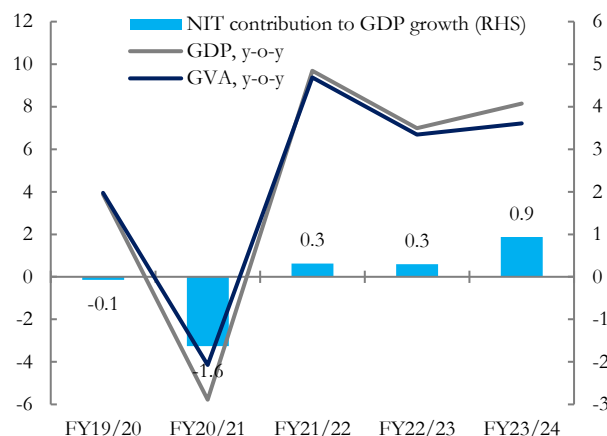
Figure 2.3: The manufacturing and construction sectors were key drivers of real GVA growth in FY23/24 (Percentage, y-o-y)



Source: NSO, CEIC, and World Bank staff calculations.

Figure 2.4: Elevated NITs resulted in a significant difference between GDP and GVA growth rates in FY23/24

(LHS: percent, y-o-y; RHS: contribution to GDP growth, percentage points)



Source: NSO, CEIC, and World Bank staff calculations. Note: NIT stands for net indirect taxes.

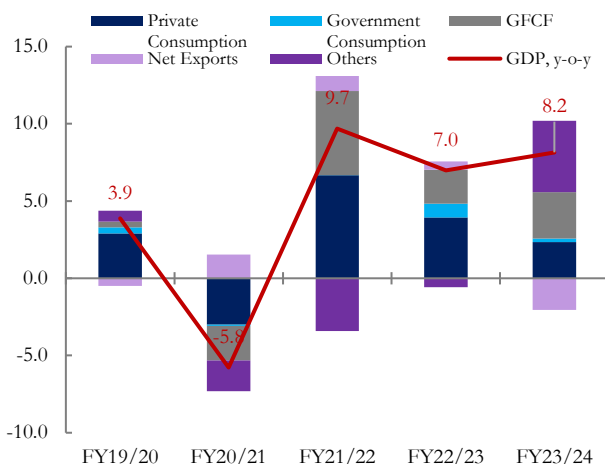
<sup>5</sup> NIT measures the difference in the prices paid by consumers (captured in GDP) and those received by producers (captured in GVA); their contribution to real growth is typically minor.

<sup>6</sup> However, the current account balance, which reflects the movement in the value of exports and imports, improved in FY23/24. This was due to lowered oil prices, which benefited India as an oil net importer.

<sup>7</sup> Discrepancies reflect difficulties in reconciling demand side indicators with supply side estimates of growth.

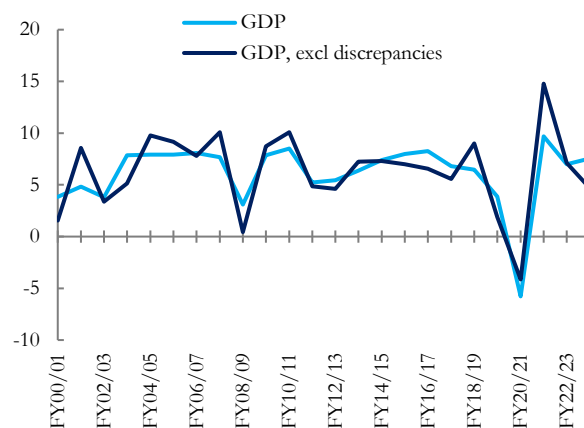


**Figure 2.5: FY23/24 GDP growth was driven by robust investment activity**  
(Contribution to GDP growth, percentage points, y-o-y)



Source: NSO, CEIC, and World Bank staff calculations.  
Note: Others comprise changes in stocks, valuables, and discrepancies.

**Figure 2.6: Discrepancies were significant in FY24/25**  
(Percentage change, y-o-y)



Source: CEIC and World Bank staff calculations.

### Box 2.1: Learning from the success of modern market services

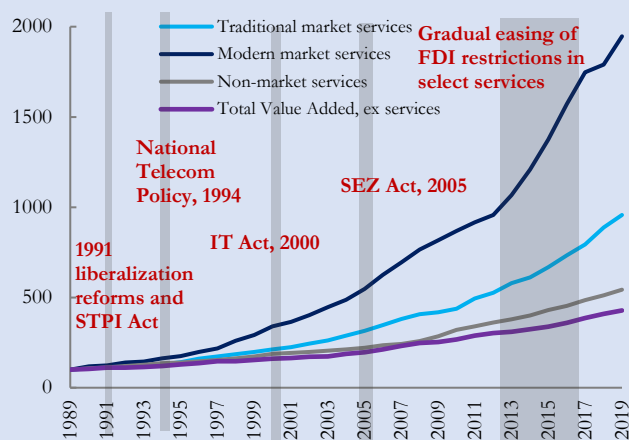
Modern market services — IT and IT-enabled services, financial services, as well as other business services— have grown by almost 13 percent annually in real terms, since 2000. These services have been exported, to a large extent, serving manufacturers outside of India. The main factors that contributed to this success include (Goswami, Gupta, & Mattoo, 2011):

- **Skills:** A large pool of trained engineers and graduate-level English-speaking workers, along with the network effects of a well-established diaspora of technical and professional workers in the US, facilitated the expansion of both the demand and supply sides for modern market services.
- **Digital infrastructure:** Gradual liberalization in the telecommunications sector helped develop ICT infrastructure and incentivized higher internet penetration. Goswami, Gupta, and Mattoo (2011) find that internet penetration had a significant and sizeable positive impact on India's exports of commercial services. Underdeveloped physical infrastructure was not a constraint because modern services are less dependent on such infrastructure than manufacturing and traditional market services (such as tourism).
- **Regulatory quality:** It improved by the late 1990s, as a result of substantial easing in product market regulations and delicensing reforms. This was particularly important for the financial sector, where deregulation was initiated in 1992.
- **Labor regulation:** The rules governing workers in the services sector under the Shops and Establishment Act are relatively flexible. Some states have also relaxed provisions of this Act for IT and IT-enabled services<sup>8</sup>.
- **Land:** Modern market services tend to be less land-intensive than manufacturing and traditional market services. Therefore, land availability and cost bottlenecks have not been binding.
- **Supportive policies:** India has gradually liberalized FDI since the mid-1990s (Figure B1-2), which has boosted growth in business services and telecommunications. Other critical policies designed to promote exports and investment were implemented post-1990, including the Software Technology Parks (STP) Act of 1991, which helped create establishments with utilities and statutory approvals; the IT Act of 2000 which provided the legal framework for electronic governance<sup>9</sup>; and the New National Telecom Policy of 1999, which restructured India's regulatory institution, introduced policies on spectrum management, and addressed standardization

<sup>8</sup> For instance, Telangana and Gujarat have released notifications exempting IT and ITES entities from certain provisions of the Act (reference number G.O. Ms. No. 5 and notification number GHR/2024/19/LED/TGS/e-file/11/2023/2453/M.3 respectively).

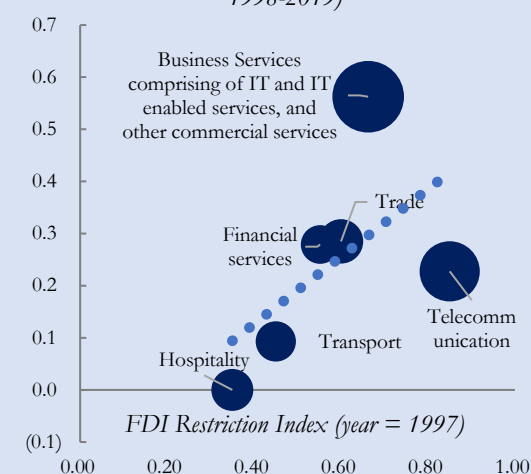
<sup>9</sup> This incorporates legal recognition of digital signatures, electronic records etc., and other aspects applying the use of ICT to deliver government services and exchange of information.

**Figure B1-1: Modern market services have grown at unparalleled pace since 2005**  
(Real GVA, Index 1990=100)



Source: KLEMS and WB staff calculations.

**Figure B1-2: FDI regulatory restrictions in services have been eased considerably since 1997**  
(X axis: FDI restriction index in 1997; Y axis: FDI restriction index in 2019, Size of bubbles: real value-added growth (CAGR), 1998-2019)



Source: OECD, KLEMS, and WB staff calculations.

Note: The FDI restrictiveness index is high for business services due to the 100 percent restriction on legal, accounting, and real estate services. The restrictions on engineering (IT and IT-enabled) services are low.

### The urban labor market continued to improve in 2023

The urban labor market improved between January and December 2023, especially for females and youth. The urban unemployment rate<sup>10</sup> declined to 6.5 percent in Q3 FY23/24, reaching its lowest level since Q2 FY17/18, when the Periodic Labour Force Survey (PLFS) first became available (Figure 2.7). Though the urban unemployment rates for men and youth edged up in Q4 FY23/24 (to 6.1 and 17 percent, respectively), the urban worker population ratio has continued to improve among all groups during this period (Figure 2.8). The annual trends in rural unemployment rate and workforce participation ratio are similar to the urban trends.<sup>11</sup> Continued improvement in education will help sustain the gains and also increase earnings (Box 2.2).

#### Box 2.2: Returns to Education in India

**Labor market returns increase with the level of education in India.** Specifically, the estimated returns to education for each successive level of schooling, relative to those of people with no education, increase at roughly a quadratic rate. On average, primary and secondary education completion is associated with 8 and 24 percent higher returns in the labor market over no education, respectively (Figure B2-1). Meanwhile, tertiary education yields an even higher premium of 73 percent.

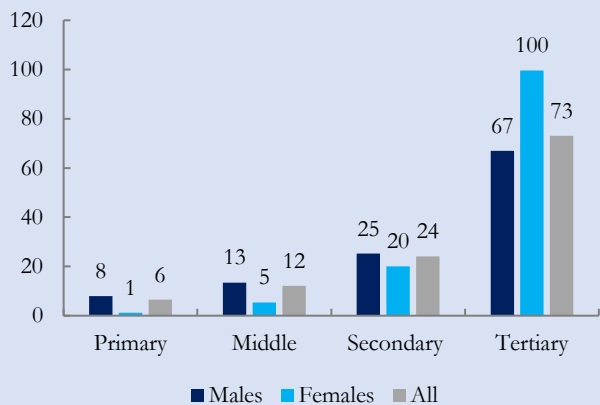
**Women benefit more in the labor market from completing higher education.** Controlling for individual-level characteristics, female workers, on average, earned 60 percent less than their male counterparts over the entire period (2017-2023). However, the wage premium associated with tertiary education is much higher for females (100 percent) than for males (67 percent).

**Returns to education have declined between 2017-18 (July-June) and 2023-24 across all levels of education** (Figure B2-2). This is consistent with findings in other countries, whereby returns to education decrease as overall educational attainment increases (as educated labor becomes less scarce).

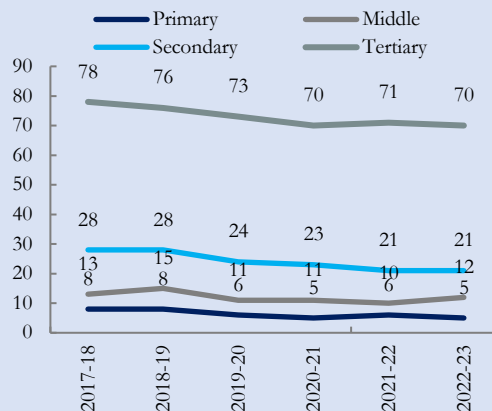
<sup>10</sup> Current weekly status (CWS) estimates from the PLFS.

<sup>11</sup> The quarterly PLFS data is only administered urban areas. Therefore, comparable quarterly trends for rural areas are not available. The comparable rural and urban trends are based on annual PLFS data.

**Figure B2-1: Returns to education are higher for tertiary education among women, PLFS 2017-18 to 2022-23 (Percentage)**

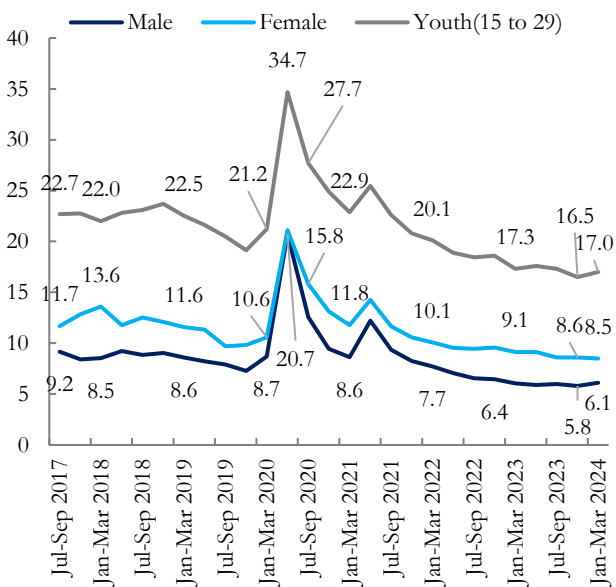


**Figure B2-2: Returns to education have declined between 2017-18 and 2022-23 (Percentage)**

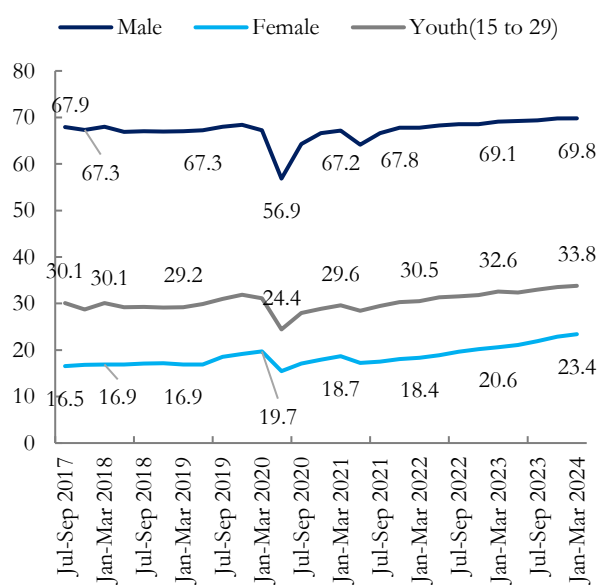


Source: Calculations are based on the Annual PLFS survey administered in both rural and urban areas (multiple years, covering July-June). The figure plots return to different levels of education for the sample, and for males and females separately. The returns to education are estimated as marginal effects from a regression of monthly wages on levels of education, controlling for other individual-level characteristics such as age, age-squared, gender, location, year of survey, sector, religion, and marital status.

**Figure 2.7: Quarterly urban unemployment rates have decreased but remained high among youth (15+ years) (Percentage)**



**Figure 2.8: Quarterly urban worker population ratios have improved across all groups (15+ years) (Percentage)**



Source: Calculations are based on the Quarterly Periodic Labor Force Survey microdata (multiple years before the data cutoff date August 15). Statistics for the last two quarters are extracted from the PLFS Quarterly Report, since the microdata is only partially released for the first visit sample for FY23/24. The sample is restricted to urban areas. The unemployment rate is the number of persons who did not work for pay in the last seven days among those in the labor force. The worker population ratio is the share of individuals employed based on the current weekly status among adults aged 15 or above.

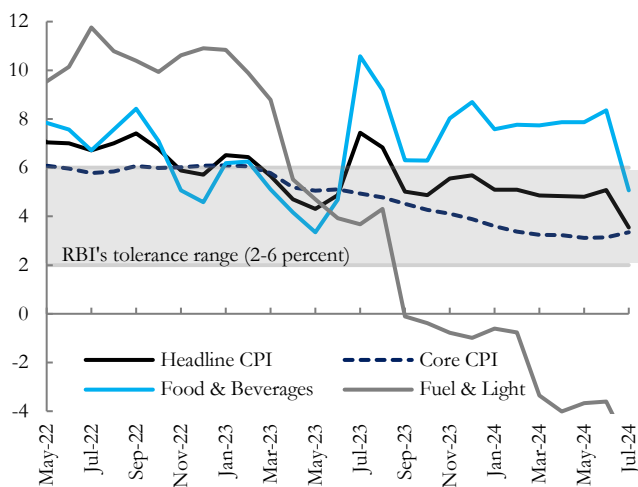
## Inflation

### Food inflation remained elevated, while fuel prices declined

Headline inflation stayed within the RBI's tolerance range of 2-6 percent throughout most of FY23/24 and moderated to a five-year low of 3.5 percent y-o-y in July 2024. There was a temporary spike in July-August 2023, due to a rise in food prices caused by adverse weather patterns. Despite measures taken by the government to address supply constraints<sup>12</sup>, food inflation remained elevated at 8.9 percent on average in Q1 FY24/25, before dropping sharply to 5.4 percent in July 2024 (largely due to base effects) (Figure 2.9). Decreasing global energy prices contributed to the continued decline in fuel inflation ("fuel and light"<sup>13</sup>) averaging 1.3 percent in FY23/24 (Figure 2.10).

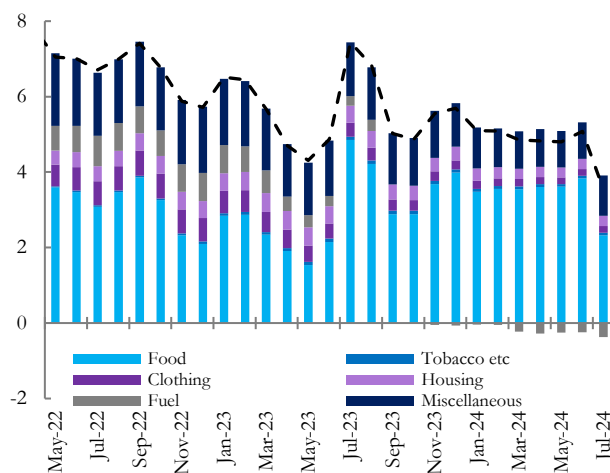
**Figure 2.9: Headline inflation moderated steadily since FY23/24...**

(Percentage, y-o-y)



Source: CEIC and World Bank staff calculations. Note: The shaded portion represents the RBI's tolerance range (2-6 percent)

**Figure 2.10: ...reflecting a fall in fuel and light inflation**  
(Contribution to headline inflation, percentage points)



Source: CEIC and World Bank staff calculations.

### Core inflation eased throughout FY23/24 and in early FY24/25

Core inflation (excluding food and fuel prices) declined to an average of 4.3 percent in FY23/24 from 6.1 percent in FY22/23 (Figure 2.11). It remained low in early FY24/25, averaging 3.2 between April-July 2024. This was driven by moderation in transport and communication inflation, following the price reduction by INR 2 per liter for petrol and diesel since mid-March 2024<sup>14</sup>. Low global commodity prices also kept wholesale price inflation (WPI) subdued at -0.7 percent on average over FY23/24. However, a rise in wholesale food and primary articles prices resulted in an acceleration in WPI between February and July 2024 (Figure 2.12).

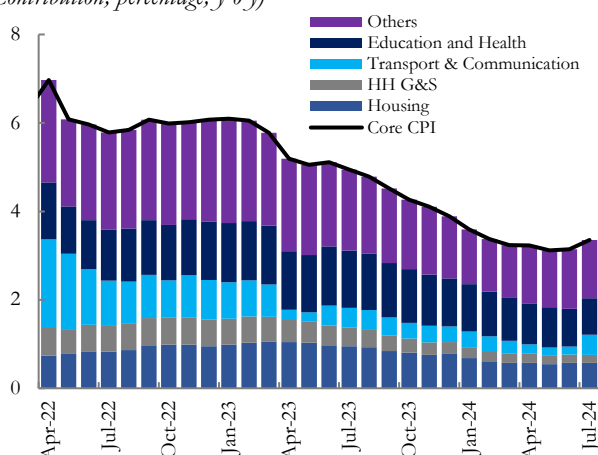
<sup>12</sup> This includes increased procurement to raise buffer stocks of food items, increased supply through the Open Market Sale scheme, temporary export bans, temporary removal of import duties, among other measures. For details see World Bank India Development update October 2023, Box 2.2.

<sup>13</sup> The fuel and light category of CPI includes the prices of cooking fuel and electricity. The sub-components are as follows: electricity, LPG (excluding that used for transportation), kerosene, diesel (excluding that used for transportation), other fuel, coke, firewood and chips, charcoal, coal and dung cake.

<sup>14</sup> The government has announced a price cut of INR 2 per liter for petrol and diesel through its state-run Oil Marketing Companies (OMCs), effective March 15, 2024. The public sector OMCs do the retail marketing and distribution of petroleum products under the administrative control of the Ministry of Petroleum and Natural Gas.

**Figure 2.11: Core inflation continued to moderate in FY24/25**

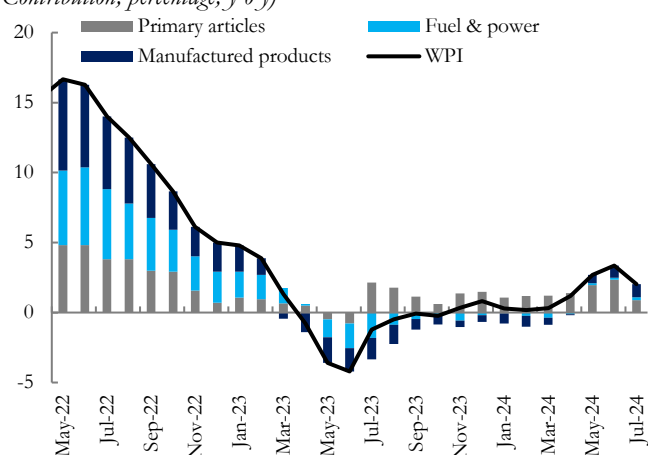
(Contribution, percentage, y-o-y)



Source: CEIC and World Bank staff calculations.

**Figure 2.12: Wholesale price inflation accelerated between February and July 2024**

(Contribution, percentage, y-o-y)



Source: CEIC and World Bank staff calculations.

## b. Monetary and financial sector

### The MPC kept the policy rate unchanged during FY23/24

After raising the policy rate by 250 basis points—to 6.5 percent—between May 2022 and February 2023, the MPC kept rates unchanged. The policy repo rate and the Standing Deposit Facility<sup>15</sup> (SDF) rate remained at 6.5 and 6.25 percent, respectively (Figure 2.13). Following its latest meeting in August 2024, the MPC refrained from rate changes, and extended the “withdrawal of accommodation”<sup>16</sup> stance.

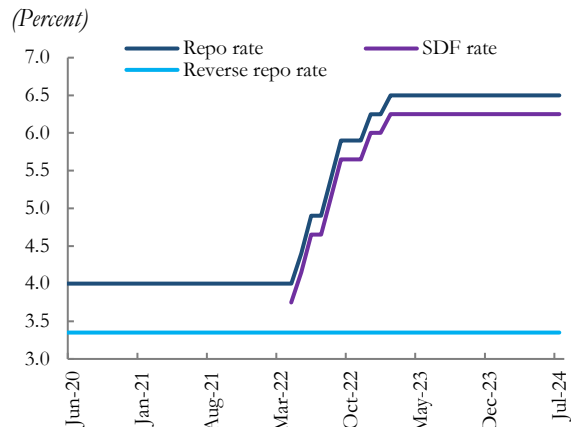
### Tight liquidity conditions prevailed in H2 FY23/24 due to limited government spending and high credit demand

Nonetheless, the RBI conducted several rounds of temporary liquidity operations in the financial system to ease short-term liquidity conditions in the banking system in the second half of FY23/24 (Figure 2.14). The tight liquidity was primarily driven by an overall moderation in government spending ahead of national elections and high credit demand, resulting in elevated overnight money market rates near the ceiling of the liquidity adjustment facility (LAF) corridor. The daily weighted average call rate exceeded the repo rate by an average of 21 bps (compared to 5 bps in the first half of FY23/24). Following several rounds of RBI operations and the end of the national elections, conditions eased gradually in recent months.

<sup>15</sup> the overnight uncollateralized deposits of commercial banks with the RBI.

<sup>16</sup> Withdrawal of accommodation refers to the RBI’s use of open market instruments to maintain inflation within the tolerance range on a durable basis. It is more targeted and has more limited impacts on growth, in contrast to policy rate increases which tend to dampen credit and growth. In response to temporary liquidity conditions, the RBI also undertakes liquidity operations to absorb excess liquidity and regulate short-term liquidity.

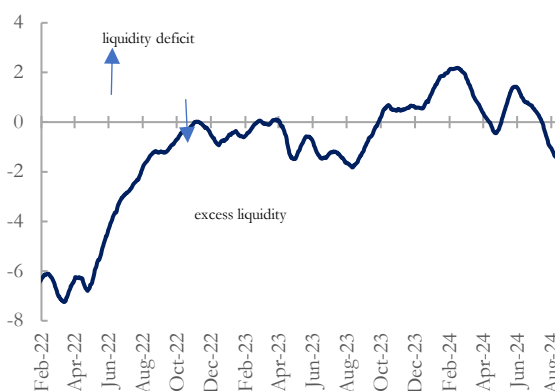
**Figure 2.13: After six successive rate hikes, the MPC has maintained the status quo in FY23/24 and thereafter**



Source: CEIC, RBI, World Bank staff calculations

**Figure 2.14: Liquidity conditions eased at end of Q1 FY24/25**

(Net liquidity injection (or absorption) from outstanding operations, 30-day rolling average, INR trillion)



Note: Liquidity refers to a 1-month rolling average of the net amount outstanding under RBI's liquidity absorption facility.

Source: RBI, World Bank staff calculations

### Fast expansion in unsecured credit caused concern

Buoyant economic activity combined with healthy bank balance sheets supported strong growth in outstanding credit of Scheduled Commercial Bank (SCBs)<sup>17</sup> which peaked at 16.3 percent<sup>18</sup> y-o-y in March 2024, before moderating to 13.9 percent in June 2024. The robust growth partially reflected a continued surge in unsecured loans, especially for credit cards, which expanded rapidly by over 25 percent during the year (on the back of a 32.5 percent increase in the previous FY). To preempt potential risks from banks' increasing exposure to unsecured loans, the RBI increased risks weights by 25 percentage points for most of these exposures in November 2023. Since then, credit growth in these portfolios has slowed slightly. Other categories of personal loans grew strongly, including housing loans (about 15 percent of the total outstanding credit), which expanded by 18.2 percent y-o-y in June 2024 (Figure 2.16). Meanwhile, bank credit to the services sector grew by almost 20.8 percent (y-o-y, up from 19.5 percent in FY22/23), primarily driven by lending to commercial real estate, and non-banking finance companies. Growth in credit to industry increased moderately to 8.0 percent in FY23/24 (compared to 5.8 percent in the previous FY).

### Asset quality improved

The asset quality of SCBs continued to improve in FY23/24, with the gross non-performing assets (GNPA) ratio of all SCBs falling to 2.8 percent in March 2024 (the latest available data, Figure 2.15), its lowest level in over a decade. Improvements occurred across all categories of financial institutions (commercial banks, co-operative banking, and non-banking financial institutions), and sectors of the economy, with the exception of the vehicles and transport equipment sector, for which it grew slightly between September 2023 and March 2024. Lower new NPA accretions, the resolution of stressed assets<sup>19</sup>, higher write-offs, and increasing sales of distressed assets to asset reconstruction companies (ARCs) contributed to the overall improvement. The capital adequacy (the capital to risk-weighted assets ratio, CRAR) for all banks remained stable at 16.8 percent in March 2024 from September 2023, but declined for private and

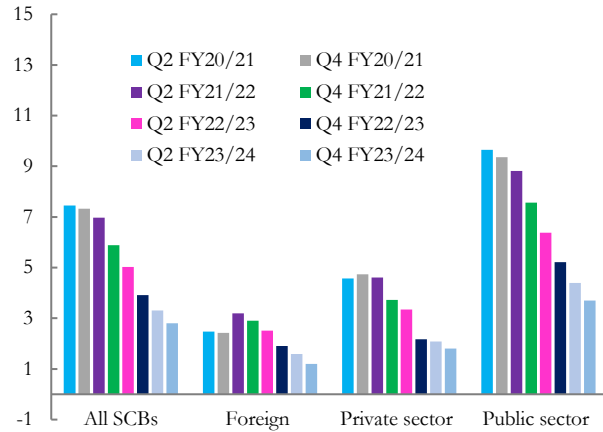
<sup>17</sup> Scheduled Commercial Banks refer to those commercial banks which have been included in the Second Schedule of the Reserve Bank of India (RBI) Act, 1934. These banks must have a paid-up capital and reserves of an aggregate value of not less than five lakh rupees.

<sup>18</sup> The growth rates in the paragraph excluded the impact of the merger of a non-bank with a bank.

<sup>19</sup> The RBI issued a framework for compromise settlements and technical write-offs on June 8, 2023 to provide further impetus to the resolution of stressed assets in the system.

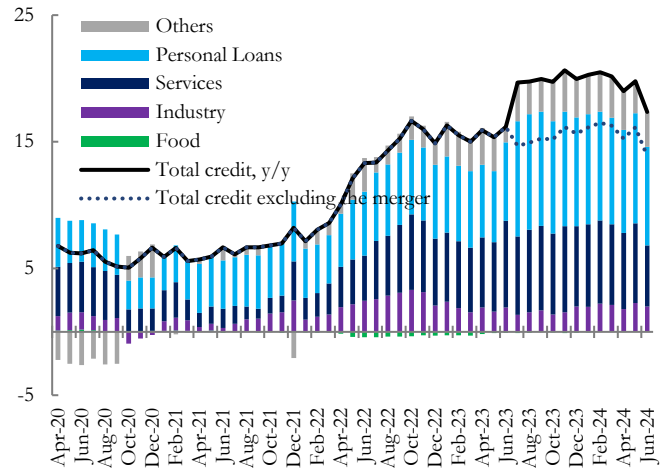
foreign banks. The decline reflected their higher shares in certain unsecured loans<sup>20</sup> with increased risk weights. The common equity tier 1 capital ratio (shareholders' equity and retained earnings) remained broadly stable at 13.9 percent in March 2024, while returns on investment increased to 13.8 percent (compared to 12.9 percent in September 2023).

**Figure 2.15: Gross NPAs have fallen across all banks**  
(Percentage of total assets)



Source: RBI, WB Staff Calculations

**Figure 2.16: Credit growth remained strong**  
(Contribution to total credit growth, y-o-y percent)



Source: RBI, World Bank staff calculations

Note: From July 2023, total credit includes the credit outstanding includes that of a bank and non-bank merger

**The yield curve flattened further amid strong demand for Indian bonds**

The benchmark yield on 10-year sovereign bonds declined from a temporary peak of 7.4 percent in October 2023 to around 7 percent in July 2024 (Figure 2.17), further flattening the yield curve (as the short-term rates remained at 7 percent due to tight liquidity conditions in the recent months). Strong demand from domestic and foreign buyers, partly linked to the expectation of US Fed rate cuts and India’s scheduled inclusion in global bond indexes (See Box 2.1), fuelled the decline.

**Financial markets continued to strengthen after a slight correction in March**

Equity markets have performed well since the beginning of FY 23/24, supported by robust corporate earnings, easing inflation, and stable global commodity prices. There were some corrections in August and March, prompted by poor economic outcomes in China and Europe; and in May due to election related uncertainties (Figure 2.18). As of August 14, 2024, the Sensex and Nifty 50 surged by 21.0 percent and 24.2 percent y-o-y, respectively. Sectors like automobiles, oil and gas, insurance, banking, and capital goods spearheaded the rally. In contrast, sectors with deep global ties, including chemicals, and IT, grew at a slower pace, reflecting weak global demand.

<sup>20</sup> Consumer credit and bank credit to NBFCs.



**Figure 2.17: 7-day average benchmark yield and short-term interest rates have stabilized since August 2023**

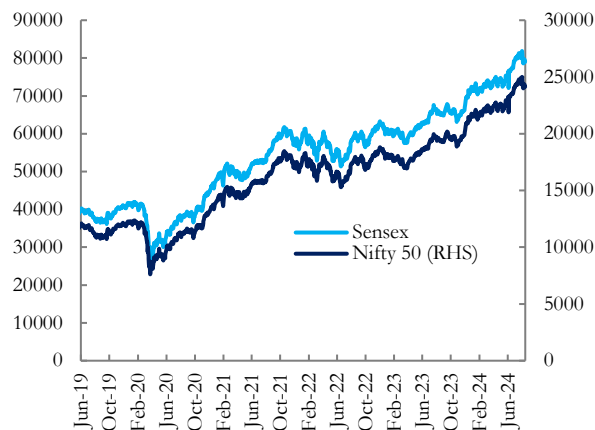
(Percent)



Source: RBI

**Figure 2.18: Financial markets have continued to strengthen**

(Index)



Source: NSE and BSE Limited

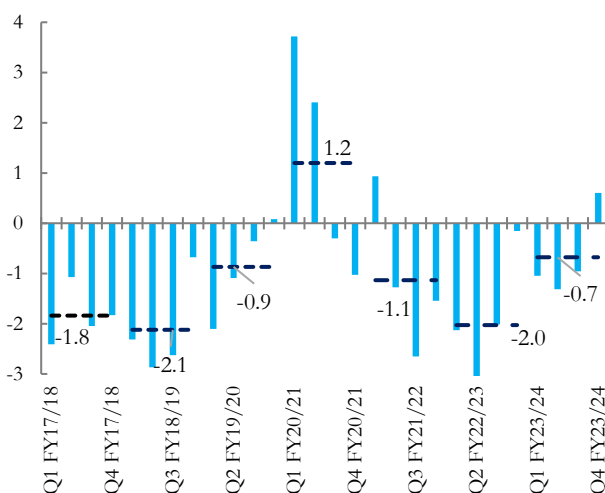
### c. External sector

**The current account deficit narrowed significantly in FY23/24 partially thanks to robust services exports**

The current account deficit is estimated to have narrowed from 2.0 percent of GDP in FY22/23 to 0.7 percent of GDP in FY23/24 (Figure 2.19), dropping well below the pre-pandemic average (FY17/18 to FY19/20) of 1.6 percent. Services trade performed particularly well, achieving a surplus of 4.6 percent of GDP during FY23/24 (from 4.3 percent in the previous year) (Figure 2.20). This is consistent with a global recovery in trade services in 2023 (grew by 8 percent<sup>21</sup>). Within the services sector, high value-added services exports, such as of software, business, and travel services grew particularly fast.

**Figure 2.19: The current account deficit narrowed in FY23/24...**

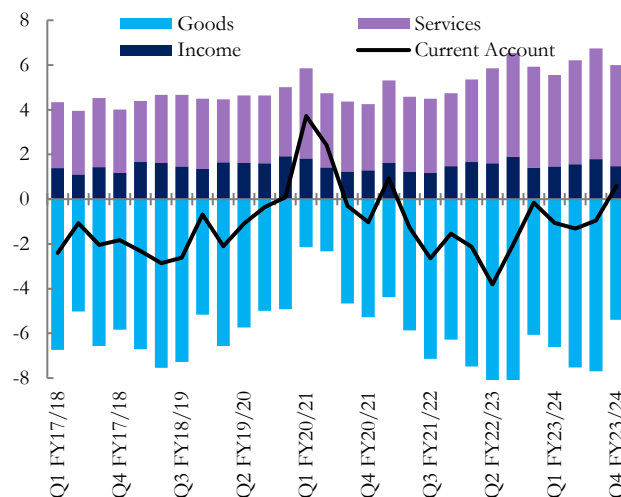
(Percentage of GDP)



Note: Dashed lines represent averages for the full fiscal years;  
Source: CEIC, RBI, World Bank staff calculations.

**Figure 2.20: ...primarily due to robust service exports**

(Percentage of GDP)



Source: CEIC, RBI, World Bank staff calculations

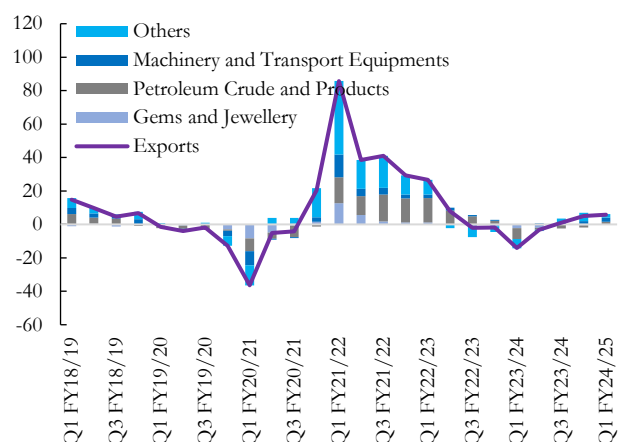
<sup>21</sup> <https://unctad.org/publication/global-trade-update-march-2024>

**Improved terms of trade helped narrow the merchandise trade deficit**

The merchandise trade deficit narrowed in FY23/24 as imports contracted more than exports in value terms (Figure 2.21 & Figure 2.22). The sharp contraction in imports was mainly due to the large drop in global oil prices, as India is a net oil importer. The exports, which contracted by a lesser extent at 0.2 percent (y-o-y), were due to a fall in non-oil merchandise exports, owing to weak global demand from India’s key trading partners, including the US and the European Union. Meanwhile, India’s exports of electronics, iron ore, and pharmaceuticals expanded, with total exports growing at 5.8 percent y-o-y in Q1FY24/25. Stronger export growth partially reflected government initiatives including the Production Linked Incentives (PLI) schemes<sup>22</sup>, the PM Gati Shakti master plan to enhance logistics infrastructure, and the Trade Infrastructure for Exports Scheme. The merchandise trade deficit increased marginally in Q1FY24/25 vis-a-vis the same period last year due to higher imports of petroleum products, electronic goods, non-ferrous metals, vegetable oil and pulses.

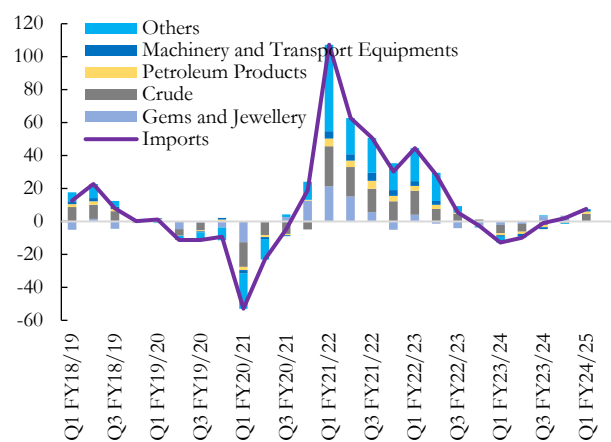
**Figure 2.21: Merchandise exports contracted in FY23/24 but are recovering since...**

*(Contribution to growth y-o-y, percentage points)*



**Figure 2.22: ... but imports contracted more in FY23/24 thanks to easing commodity prices**

*(Contribution to growth y-o-y, percentage points)*



Source: CEIC, Ministry of Commerce and Industry, World Bank staff calculations

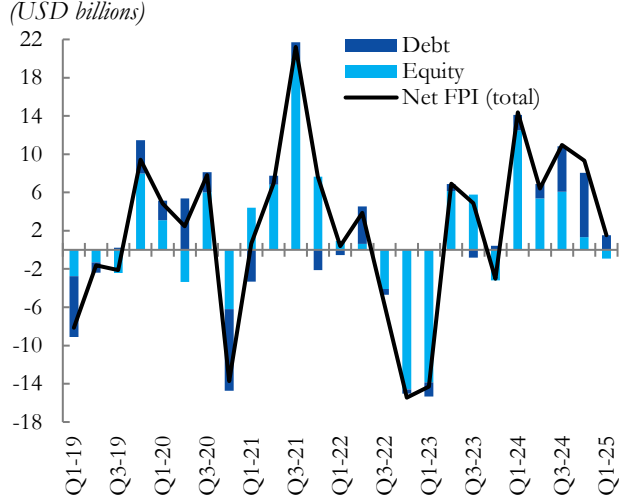
**Foreign portfolio flows surged, while foreign direct investment remained muted**

Net foreign Portfolio Investment (FPI) inflows rose to US\$41.6 billion in the FY23/24 (compared to an outflow of US\$4.8 billion in FY22/23) (Figure 2.23). The increase reflected market expectations about US Federal Reserve’s (Fed) rate cuts (making the yields on Indian sovereign debt more attractive vis-à-vis the US treasuries), as well as India’s strong macro fundamentals (a robust growth outlook, stabilizing inflation, and a relatively stable currency). Investors in Indian securities were also possibly incentivized by India’s imminent inclusion in global bond indexes<sup>23</sup> (Box 2.3). However, portfolio inflows dropped in the first quarter of FY24/25 due to increased uncertainties around the national elections. By contrast, net FDI moderated to 0.3 percent of GDP in FY23/24 (from around 0.8 percent in FY22/23), mainly due to a surge in repatriation from 0.9 percent to 1.2 percent of GDP (Figure 2.24). Nevertheless, gross FDI remained stable at US\$71.4 billion in FY23/24 (compared to US\$71 billion in FY22/23). During April-May FY24/25, both gross and net FDI picked up significantly compared to the same period in FY23/24.

<sup>22</sup> See footnote 2

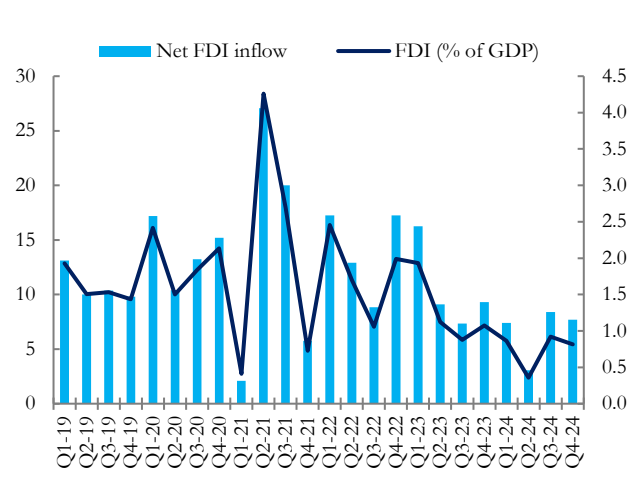
<sup>23</sup> Late in 2023, JP Morgan announced India’s inclusion in its Global EM Bond Index, a decision that could redefine the country’s financial landscape. In March 2024, Bloomberg made its own announcement of India’s inclusion into its EM Local Currency Government indices.

**Figure 2.23: FPI inflows were robust in FY23/24, declining in Q1 FY24/25**  
(USD billions)



Source: CEIC, RBI, World Bank staff calculations

**Figure 2.24: FDI inflows remained muted**  
(USD billions, left axis); (Percentage of GDP, right axis)

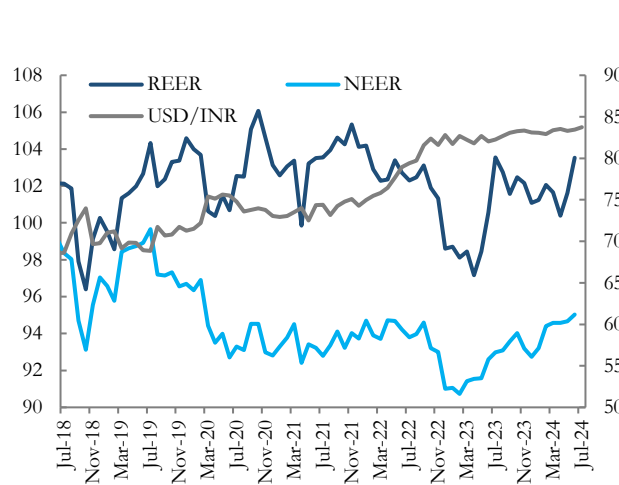


Source: CEIC, RBI, World Bank staff calculations

**The rupee was relatively stable**

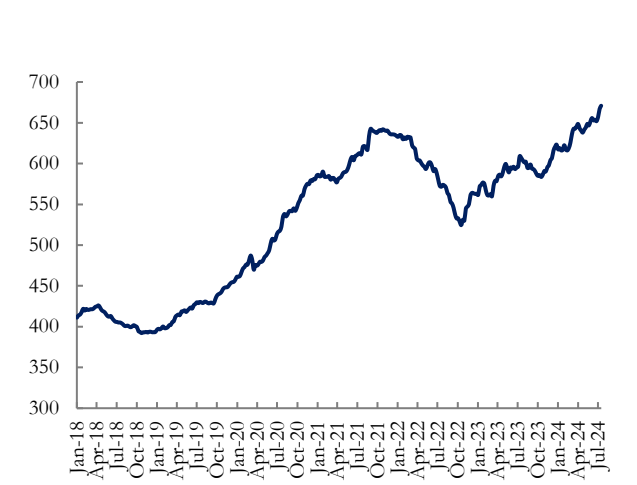
In FY23/24, the rupee depreciated marginally by 2.7 percent against US dollars (compared to a depreciation of about 8 percent in FY22/23)(Figure 2.25). The nominal effective exchange rate (NEER)<sup>24</sup> and real effective exchange rate (REER)<sup>25</sup> appreciated by 2.3 percent and 3.5 percent respectively in June 2024, compared to June 2023. The relative stability of the rupee was linked to India’s strong growth, declining merchandise trade deficit, robust capital inflows, and RBI operations in the foreign exchange market to mitigate volatility. Foreign exchange reserves reached an all-time high of US\$670.1 billion as of August 9 2024, equivalent to over eleven months of import cover (Figure 2.26).

**Figure 2.25: INR depreciated marginally in FY23/24**  
(INR/US\$)



Source: Haver, IMF, World Bank staff calculations  
Note: a higher value indicates depreciation.

**Figure 2.26: Forex reserves at an all-time high**  
(US\$ billion)



Source: CEIC, RBI, World Bank staff calculations

<sup>24</sup> NEER compares rupee’s value against a weighted average of major trading partners’ currencies.

<sup>25</sup> REER compares NEER adjusted for inflation differential with the major trading partners.

### Box 2. 3: Implications of India's inclusion in global bond indices

**Two major global bond indices will soon include Indian Government Bonds (IGBs).** J.P. Morgan announced the inclusion of IGBs in its Government Bond Index-Emerging Markets (GBI-EM) in October 2023 (with investment flows starting from June 2024), while the Bloomberg Index Services announced the inclusion of IGBs in the Emerging Market Local Currency Index in March 2024, with investment flows starting from January 2025.

**The bond indices will passively invest in IGBs in a phased manner.** In each country, the indices select government bonds that meet certain criteria (such as having a minimum outstanding issue size). The indices assign weights to each country, and the weight determines the share of the total assets under management that are invested in the selected bonds. Investors in these indices are deemed to be "passive" because their funds are automatically allocated to bonds in proportion to country weights. From June 2024 onward, each month, selected IGBs will receive an incremental 1 percent weight in the GBI-EM index, up to an estimated 10 percent target and the bonds will be included in a similarly phased manner in the Bloomberg index from January 2025.

**India attracted additional inflows leading up to the bond index inclusion.** Even though India's inclusion in the index only took effect from June 2024 onward, data suggests that active investors already started to rebalance their portfolios (as prices of IGBs were expected to go up once they are formally included in the index). Monthly data on foreign portfolio investment in sovereign debt showed an increase in net inflows since the announcement of bond inclusion in October 2023 (Figure B3-1).

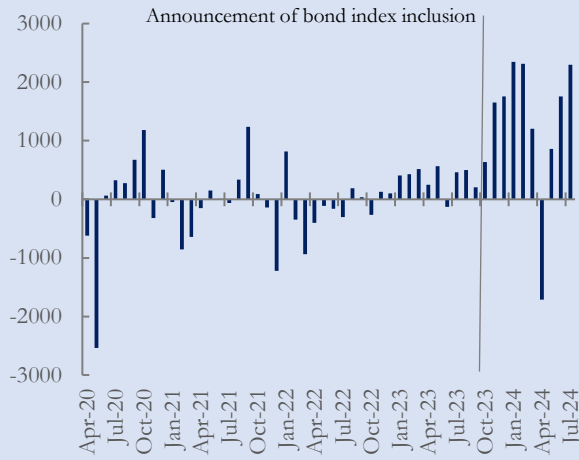
**The inclusion of Indian bonds into the index is likely to impact the balance of payments dynamics primarily in FY24/25.** Between June 2024 and March 2025, India is expected to receive additional inflows of about US\$25bn (around 55 percent of average net capital inflows in the previous five years). The main implications include:

- Appreciation pressure on the exchange rate (all else equal) that could affect India's export competitiveness;
- Downward pressure on government bond yields and the term premium (Figure B3-2);
- A commensurate decline in corporate bond yields, as they are benchmarked with government bonds;
- Increased liquidity in the banking sector.

**The benefits and risks of bond inclusion are likely to increase as the transition towards passive investing continues through India's inclusion in more index funds.** With the inclusion of India's bond in the GBI-EM and the Bloomberg Index, other index managers may soon follow suit. On the upside, inclusion in global bond indices would give India access to a more extensive and more diversified pool of external financing. Furthermore, greater exposure to international capital flows can incentivize domestic reforms as India's policies attract more market scrutiny, and market discipline is brought to bear on macro policies.

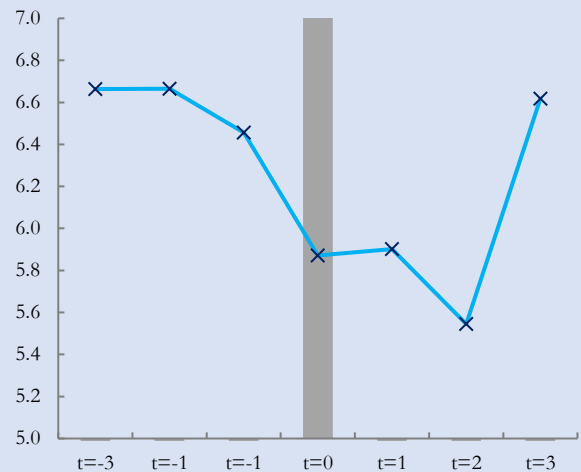
On the downside, greater financial integration could be a source of vulnerability because it increases the country's exposure to external shocks as capital flows become more sensitive to external conditions (Figures B3-3 and B3-4). In 2008, the Indian bond market remained relatively shielded from the global financial turmoil because of the capital account restrictions. However, after the inclusion of Indian bonds in global indices, domestic bond yields may become more sensitive to global developments. That said, the potential downside is limited by the RBI's cap on total foreign ownership of government bonds at 6 percent of the outstanding stock of securities.

**Figure B3-1. FPI flows into sovereign debt have already increased since the announcement in October 2023**  
(Index number)

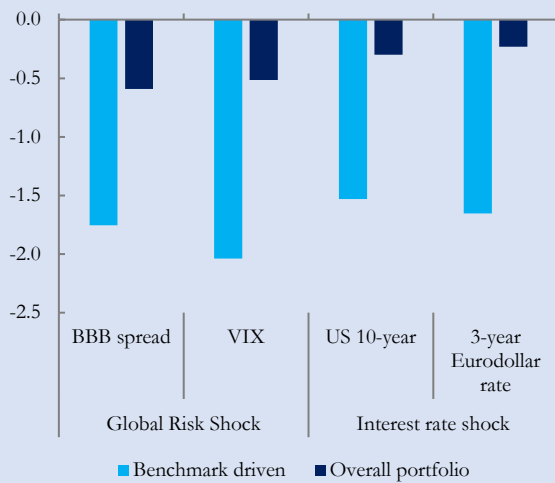


Source: Haver Analytics, World Bank staff calculations

**Figure B3-2. Performance of 10-year sovereign bond yield before and after inclusion in major global bond indices<sup>26</sup>**  
(Percentage)

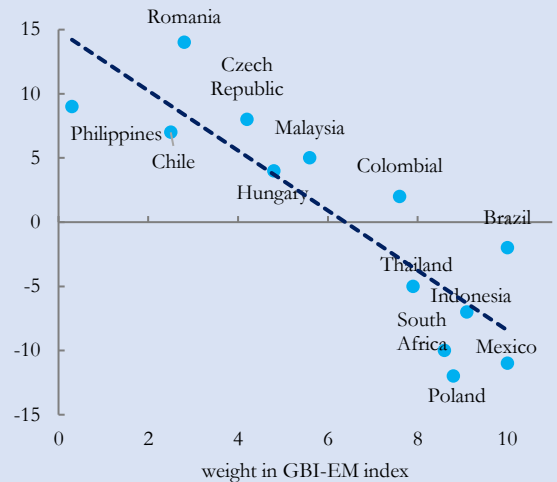


**Figure B3-3. Benchmark-driven debt inflows are more sensitive to external shocks.<sup>27</sup>**  
(Percentage of invested assets)



Source: Arslanalp et al. (2020) Source: OECD, World Bank staff calculations

**Figure B3-4. Portfolio outflows during COVID-19 and country weights in GBI-EM index**  
(USD billion)



#### d. Fiscal developments and debt sustainability

**The central government's fiscal deficit narrowed to**

Strong revenue collection helped narrow the central government fiscal deficit to 5.6 percent in FY23/24, down from 6.4 percent in FY22/23 and below the budgeted target of 5.9 percent. Based on monthly provisional accounts data, total revenues of the

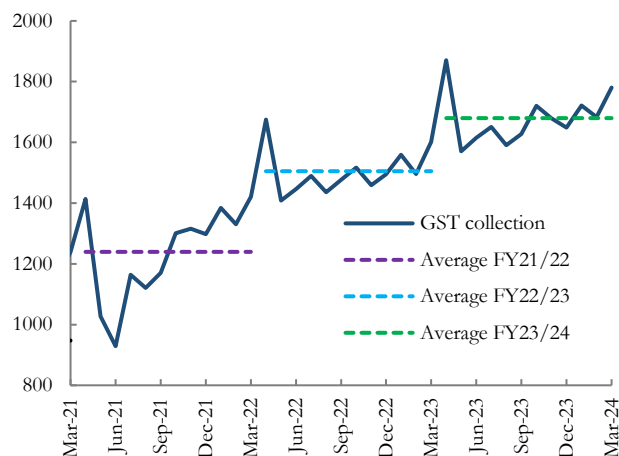
<sup>26</sup> The analysis includes annual average movement in 10-year sovereign bond yield for China, Colombia, Czech Republic, Mexico, Nigeria, Romania, and South Africa. T=0 denotes the year when the eligible sovereign bonds of these countries were included in GBI-EM or any other major benchmark driven global bond index.

<sup>27</sup> Note: Global risk shock is captured by 1 standard deviation (sd) increase in spread between BBB rated US corporate bond and sovereign bond and 1 sd increase in volatility of US stock market (VIX). Interest rate shock is captured by 1 sd increase in US 10-year yield and 3-year Eurodollar rate.

**5.6 percent in FY23/24, driven by robust revenue growth...**

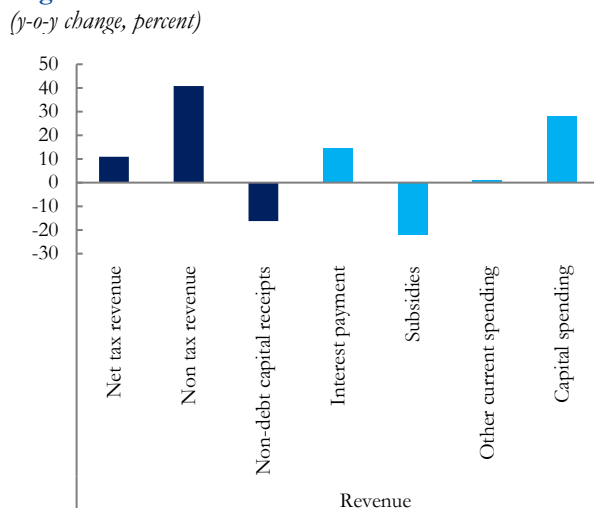
center are estimated to have increased by 13.6 percent y-o-y in FY23/24, thanks to robust growth in direct tax collection (17.6 percent y-o-y). Goods and Services Tax (GST) revenues also increased by 12.7 percent. (Figure 2.27). Non-tax revenues grew by over 40 percent, largely due to a large increase in dividends and profits from the RBI and state-owned enterprises. (Figure 2.28).

**Figure 2.27: GST collection has continued to grow at a robust pace**  
(GST collection, INR billion)



Source: CEIC, Ministry of Finance, and WB staff calculations

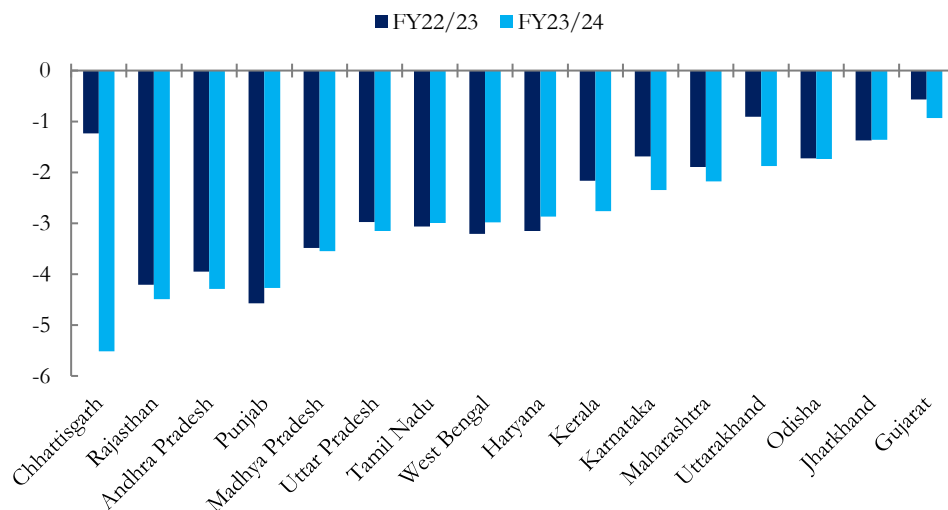
**Figure 2.28: Strong revenue growth and lower subsidies helped the central government meet its fiscal deficit target**  
(y-o-y change, percent)



**... and only modest growth in current expenditure**

Central government expenditures grew by 5.9 percent y-o-y, with a shift from current toward capital spending. Current expenditure rose by 1.2 percent, with spending on food and fertilizer subsidies declining precipitously by over 22 percent. Capital expenditure, however, surged by 28 percent, increasing its share of total spending to over 21 percent in FY23/24 from 17.6 percent in FY22/23.

**Figure 2.29: The fiscal deficit increased for many major states in FY23/24**  
(Percentage of GDP)



Note: Data for FY23/24 are provisional accounts  
Source: State budget documents and WB staff calculations

**The states' fiscal deficit marginally expanded**

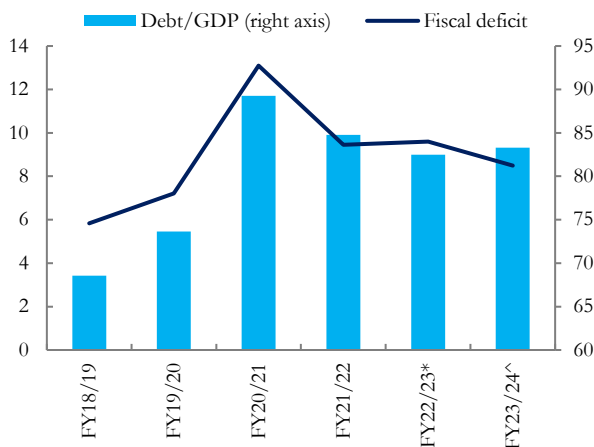
The combined fiscal deficit of states is estimated to have reached 2.9 percent of GDP<sup>28</sup> (Figure 2.29) over FY23/24. This is marginally higher than the deficit in FY22/23 but narrower than the revised estimates for FY23/24. Robust revenue growth was offset by an increase in capital spending, which grew by over 24 percent y-o-y (compared to the 12 percent increase in FY22/23). The composition of expenditure thus shifted toward capital expenditure as growth in current spending was relatively modest. This shift may have a positive impact on private investment and medium-term growth (See Box 2.3). Revenue collection rose by over 9 percent y-o-y, driven by strong growth in taxes devolved from the central government (21 percent) and own-tax revenues (15 percent y-o-y), while grants from the central government fell by 20 percent y-o-y. The discontinuation of GST compensation grants and the reduction in revenue deficit grants for certain states contributed to the lower central grants.

**The general government fiscal deficit declined in FY23/24 while the public debt-to-GDP ratio increased**

The general government fiscal deficit declined to 8.5 percent of GDP in FY23/24 (Figure 2.30 & Figure 2.31). However, on account of relatively moderate growth in nominal GDP, public debt rose from 82.5 percent of GDP in FY22/23 to 83.9 percent in FY23/24.

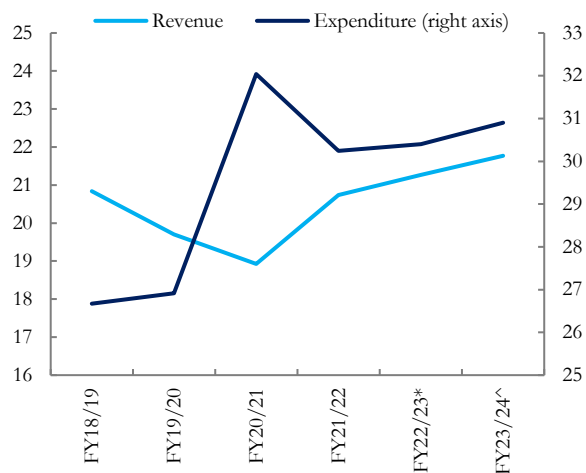
**Figure 2.30: The general government fiscal deficit remained stable in FY23/24, and the debt/GDP ratio increased**

(Percentage of GDP)



**Figure 2.31: Both expenditure and revenue increased as a share of GDP**

(Percentage of GDP)



Note: \*Based on revised estimates and provisional accounts.

Source: CEIC, RBI, CSO, and WB staff calculations

<sup>28</sup> within the 3.5 percent of GSDP borrowing limit proposed by the central government (including the additional 0.5 percent of GSDP, conditional on the adoption of power sector reforms)



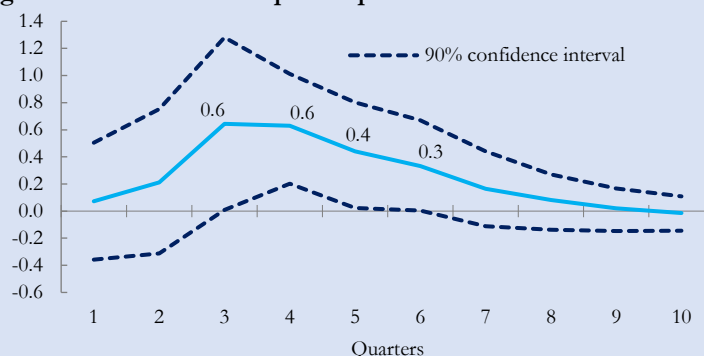
#### Box 2.4: Capital spending has a positive impact on economic output

A concern associated with increased public spending is that such expenditures “crowd out” the private sector: higher public investment may raise the cost of borrowing and thereby undermine the private sector’s assessment of potentially profitable investments. However, some types of public investments tend to “crowd in” private investment, including infrastructure that facilitates market access, increases efficiency, or promotes innovation<sup>29</sup>.

**India’s central government’s capital expenditure is estimated to “crowd in” private investment.** Over the

past two decades (2000-20), on average, current (or revenue) expenditure accounted for more than 80 percent of total central government spending. Compared to such expenditure, increases in capital expenditure can have a more significant impact on growth. A study found that the current expenditure multiplier is estimated to be less than one, while capital expenditure is 2.4 to 6.5 times in size (Goyal and Sharma, 2018). It is estimated that GDP can rise by 2.8 to 4.1 rupees for every one rupee increase in the central

**Figure B4-1: Estimated impact of public investment on real GDP**



Source: WB staff calculation; Note: see Figure B3-2

government capital expenditure (Figure B4-1). Public investment is also estimated to “crowd in” private investment and formal manufacturing employment and raise real wages, although with a lag of a couple of years (Figure B4-2). Other studies also support the results: Bose and Bhanumurthy (2015) find a large capital expenditure multiplier of 2.5 against a current spending multiplier of 1.<sup>30</sup> Jain and Kumar (2013) find that capital outlay (for both central and state governments) is more growth-inducing with a multiplier effect that continues for up to four years, while the impact of current expenditures dissipates immediately after the first year.<sup>31</sup>

**Capital outlays at the state level, particularly on urban development, transport, agriculture, and allied activities, have similar positive impacts on growth.** A one rupee increase in capital outlay for development purposes increases the states’ real GDP by 0.4 rupees after two years. The cumulative multiplier, however, fades over time<sup>32</sup> (Figure B4-2a). Loans and advances for development purposes do not have a statistically significant impact on state GDP<sup>33</sup>. The most considerable multiplier impacts on state output, within capital outlay for development purpose categories, stem from urban development— with a one rupee increase leading to a 2.5 rupee increase in state output in the first year and the cumulative multiplier remaining large and statistically significant over the next four years (Figure B4-2b). Spending on transport also increases state output by 0.9 rupees after two years (Figure B4-2c). Expenditure on agriculture and allied activities raises state output by 1.2 rupees in the first year, at a 10 percent level of significance (Figure B4-2d). However, spending on these categories was only 0.7 percent of GDP in 2020.

<sup>29</sup> Calderón, et. al. (2015)

<sup>30</sup> They use a structural macroeconomic model based on annual data from 1991 to 2012.

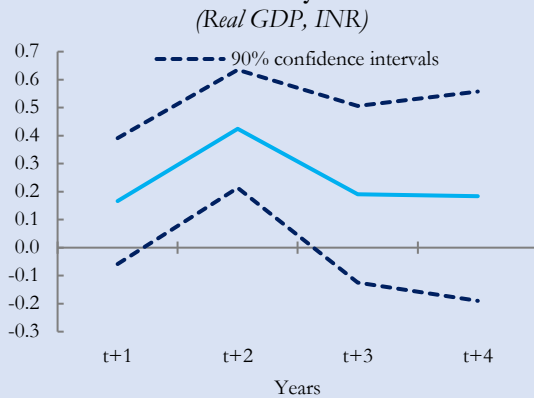
<sup>31</sup> The size of capital outlay multiplier at state level is 2.13, significantly higher than 0.39 estimated for the central government.

<sup>32</sup> The estimates are based on the panel local projection model, following Jordà, (2005).

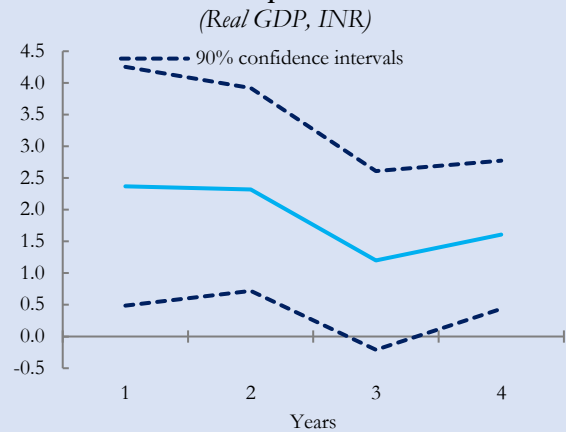
<sup>33</sup> The aggregate multiplier combining both capital outlays and loans & advances is also statistically insignificant.

**Figure B4-2: State-level fiscal multipliers for categories of development capital outlay**

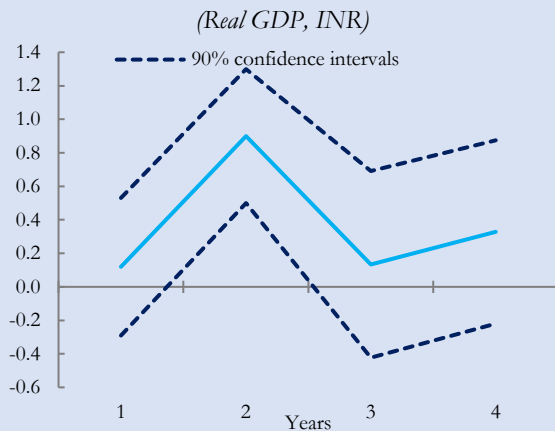
a. Impact of a rupee increase in **development capital outlay**



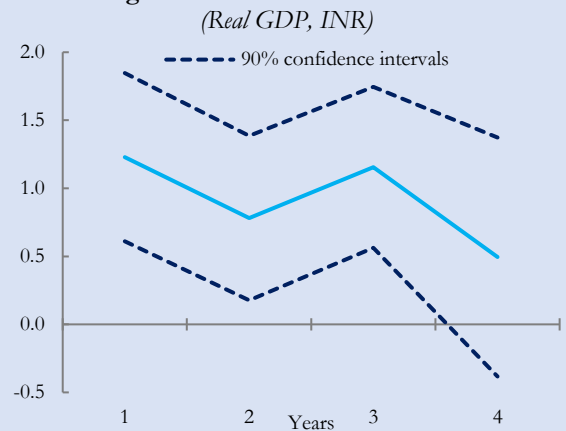
b. Impact of a rupee increase in **urban development expenditure**



c. Impact of a rupee increase in capital outlay for **transport**



d. Impact of a rupee increase in capital outlay for **agriculture and allied activities**

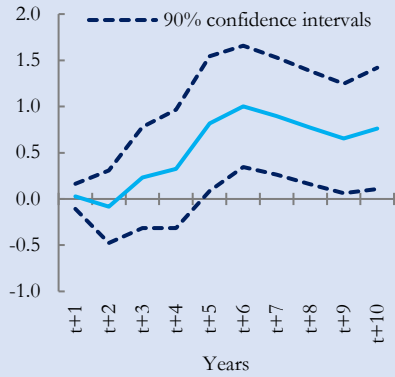


**Source:** Chaudhary, Ulrich and Sharma, forthcoming. **Note:** Results are based on a panel local projection model including state taxes, GDP deflator, state output gap, state revenue expenditure, a dummy for the 2009 Great Recession, and a lag in the variable of interest. The reported variable is the equivalent of a cumulative multiplier **Invalid source specified**.

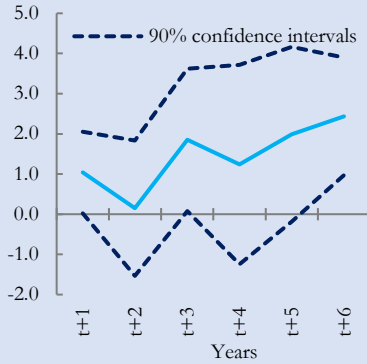
Private investment and the labor market also benefit from states' capital outlays for development. Development capital outlays lead to a statistically significant increase in the private sector capital stock in states and hence net private investment, albeit with a considerable lag (Figure B4-3a). Employment increases by one percent in the first year on higher capital outlay, and the impact is powerful after five years as private investment increases (Figure B4-3b). Capital outlay for development purposes is also associated with a wage increase: a one percentage point increase leads to a 1.8 percent increase in real wages per worker after four years. However, the impact is insignificant in the initial years (Figure B4-3c).

**Figure B4-3: Private investment and labor market outcomes**

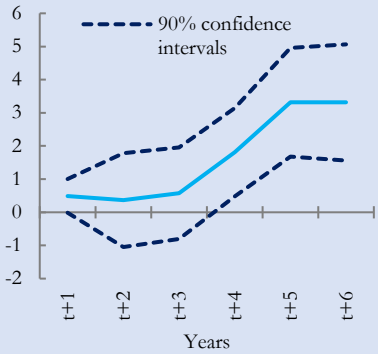
a. Impact of a rupee increase in **capital outlay** for development purposes on states' **capital stock**  
(*Real Investment, INR*)



b. Impact of a 1 percent shock to **capital outlay** for development on **employment**  
(*Employment, percentage*)



c. Impact of a 1 percent shock to **capital outlay** for development on **real wages per capita**  
(*Real wages per capita, percentage*)



**Source:** WB staff calculations. **Note:** Based on a panel local projection model including state taxes, GDP deflator, state output gap, state revenue expenditure, a dummy for the 2009 great recession, and a lag the variable of interest. The findings are robust in the estimation of the Generalized Method of Moments (GMM).

### 3. Outlook

**External conditions to remain subdued in 2024...**

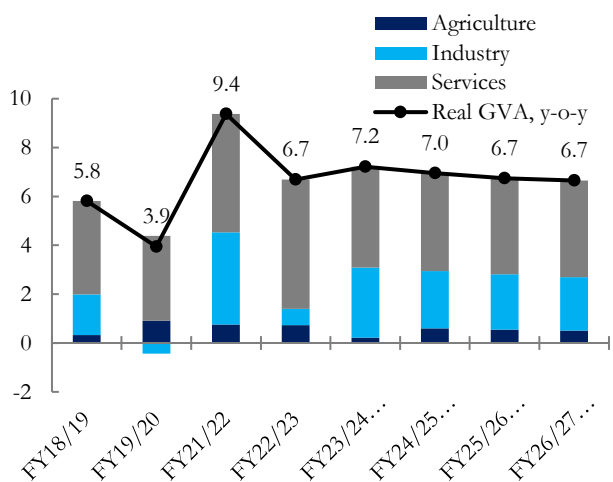
Global growth is expected to hold steady at 2.6 percent in 2024<sup>34</sup>. India’s top two trading partners—the US and EU—are expected to perform better than initially thought, albeit bellow historical averages. Global trade and investment flows will likely recover gradually and the market expects major central banks will start cutting rates later this year. However, inflationary pressures on commodity prices could result from evolving geopolitical tensions.

**... but India’s economic growth will remain strong in FY24/25**

Amid challenging external conditions, India’s growth is projected to remain strong at 7.0 percent in FY24/25 (Table 3.1). Industry and services activity is expected to decelerate on account of subdued external demand, and the general slowdown of activities, particularly capex, during the election period in the first months of the fiscal year. However, the agriculture sector is expected to rebound on the back of above-average monsoon rainfall and increased sowing area (Figure 3.1).

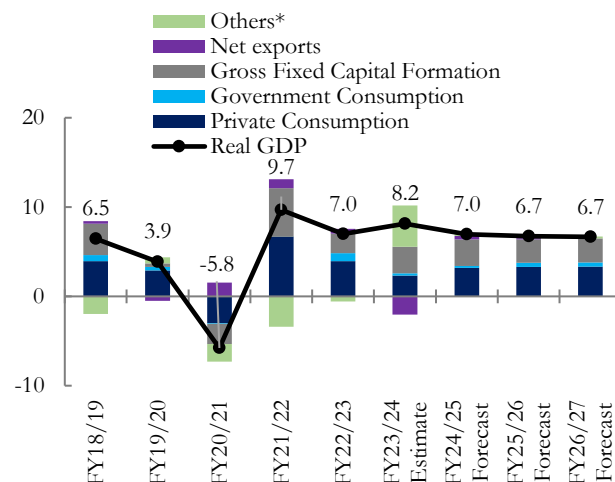
**Figure 3.1: Real GVA growth holding steady in FY24/25**

*(Contribution to growth, percentage)*



**Figure 3.2: A slight moderation in investment but rebounding consumption in FY24/25**

*(Contribution to growth, percentage)*



Source: CEIC, MoSPI, and World Bank staff calculations.

\*Note: Others mainly include discrepancies.

**Consumption should pick up, while investment activity slows down from the peak**

On the expenditure side, the high base in FY23/24 will weigh on investment growth in FY24/25, which is projected to decelerate from 9.0 percent in FY23/24 to 7.8 percent in FY24/25. This reflects slower growth in government investment, partly offset by an expected pick up in private investment. By contrast aggregate consumption growth is expected to accelerate to 5.7 percent in FY24/25, up from 4.0 percent in FY23/24. Private consumption is expected to rise as farmers’ incomes recover, and government consumption increases faster than in previous years. Contribution to growth from net exports are expected to turn positive, as merchandise export growth rebounds from a weak performance in the previous year (Figure 3.2).

<sup>34</sup> Global Economic Prospect, World Bank, June, 2024.

**Economic growth is projected to remain strong**

In the medium term, growth is expected to remain robust, assuming gradual improvements in the global environment, no major external shocks and a positive boost from recently adopted pro-growth policies. The positive outlook is anchored on sustained growth of the services sector (including the expansion of Global Capability Centers (GCC)), and an expected strengthening of the manufacturing sector, supported by government initiatives (the PM Gati Shakti master plan to enhance logistics infrastructure, the Trade Infrastructure for Exports Scheme, and increased tax efficiency and rationalized tax rates to improve the business environment). The government has also introduced the PLI schemes since 2020 to support the private sector and manufacturing, though more data and a longer time period are needed to assess their long-term impacts. Private consumption is expected to pick up, benefiting from continued improvements in the labor market, growth in rural incomes, and declining inflation. The public investments carried-out over the recent years are expected to crowd in private investment, which will be further facilitated by the healthy balance sheet of the domestic financial sector and corporates, and the gradual loosening of global liquidity.

**Headline inflation should subside but remain relatively elevated**

Headline inflation is expected to continue to decline from an average of 5.4 percent in FY23/24 to 4.5 percent in FY24/25, reflecting stable global oil prices and an expected moderation in food prices. Over the medium term, risks persist from unexpected adverse weather conditions, which could constrain the food supply, and an escalation of geopolitical tensions affecting oil markets.

**The CAD is expected to stabilize at around 1.5 percent of GDP over the medium term**

The CAD is projected to widen to 1.1 percent of GDP in FY24/25 from 0.7 percent in FY23/24. Merchandise imports are expected to increase, in nominal terms, as commodity prices stabilize, compared to a decline in the previous fiscal year. Merchandise export growth is also anticipated to pick up thanks to recovering global trade<sup>35</sup>. India's strong performance in high- and medium-technology export goods is expected to continue as is robust growth of services exports, especially of IT and professional services. In the medium term, the CAD is expected to settle at around 1.5 percent of GDP, adequately financed by foreign (direct and portfolio) investment.

**The central government is targeting a fiscal deficit of 4.9 percent of GDP in FY24/25**

The central government is expected to continue fiscal consolidation in FY24/25 and over the medium term, as indicated in the post-election budget. The fiscal deficit is expected to narrow from 5.6 percent of GDP in FY23/24 to 4.9 percent in FY24/25, and further to 4.5 percent by FY25/26, mainly driven by continued consolidation of current spending. Growth in capital spending is projected to remain buoyant, but to moderate from 28 percent in FY23/24 to 16 percent in FY24/25. Overall revenue growth should remain robust, primarily thanks to growing proceeds from corporate and personal income taxes.

**The states' fiscal deficit is projected to remain around 3 percent in FY24/25, narrowing the general government deficit**

The combined fiscal deficit from states should remain stable around 3.0 percent of GDP in FY24/25, assuming relatively modest growth in both revenues and expenditure, of 9 percent and 7 percent, respectively. Growth in capital outlays is projected to slow, to 5.5 percent, after the rapid increase in the previous fiscal year, while current spending is projected to increase by 7.6 percent. The general government deficit is projected to decline to below 7.5 percent of GDP over the medium term. Combined with robust GDP growth, this should lead to a decline in general government debt to 82 percent by the end of FY26/27.

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<sup>35</sup> UNCTAD, Global Trade Update (July 2024)

**Table 3.1: World Bank macroeconomic outlook indicators**

<b>Indicator</b> <i>(percent y-o-y growth, unless otherwise specified)</i>	<b>FY21/22</b>	<b>FY22/23</b>	<b>FY23/24e</b>	<b>FY24/25f</b>	<b>FY25/26f</b>	<b>FY26/27f</b>
<b>Real GDP Growth at constant market prices</b>	9.7	7.0	8.2	7.0	6.7	6.7
Private Consumption	11.7	6.8	4.0	5.7	6.0	6.1
Government Consumption	0.0	9.0	2.5	4.3	5.0	5.0
Gross Fixed Capital Formation	17.5	6.6	9.0	7.8	7.7	7.7
Exports, Goods and Services	29.6	13.4	2.6	7.2	7.2	7.9
Imports, Goods and Services	22.1	10.6	10.9	4.1	6.3	7.3
<b>Real GDP Growth, at constant factor prices</b>	9.4	6.7	7.2	7.0	6.7	6.7
Agriculture	4.6	4.7	1.4	4.1	3.9	3.7
Industry	12.2	2.1	9.5	7.6	7.3	7.2
Services	9.2	10.0	7.6	7.4	7.1	7.1
<b>Inflation (Consumer Price Index)</b>	5.5	6.7	5.4	4.5	4.1	4.0
<b>Current Account Balance</b> <i>(percent of GDP)</i>	-1.2	-2.0	-0.7	-1.1	-1.2	-1.6
<b>Net Foreign Direct Investment</b> <i>(percent of GDP)</i>	1.2	0.8	0.3	1.0	1.2	1.5
<b>Fiscal Balance</b> <i>(percent of GDP)</i>	-9.5	-9.6	-8.5	-7.8	-7.6	-7.3
<b>Debt</b> <i>(percent of GDP)</i>	84.8	82.5	83.9	83.7	83.0	82.0
<b>Primary Balance</b> <i>(percent of GDP)</i>	-4.2	-4.0	-3.1	-2.5	-2.3	-2.2

Source: CEIC and World Bank Staff calculations

Note: (i) Shaded columns are WB forecasts

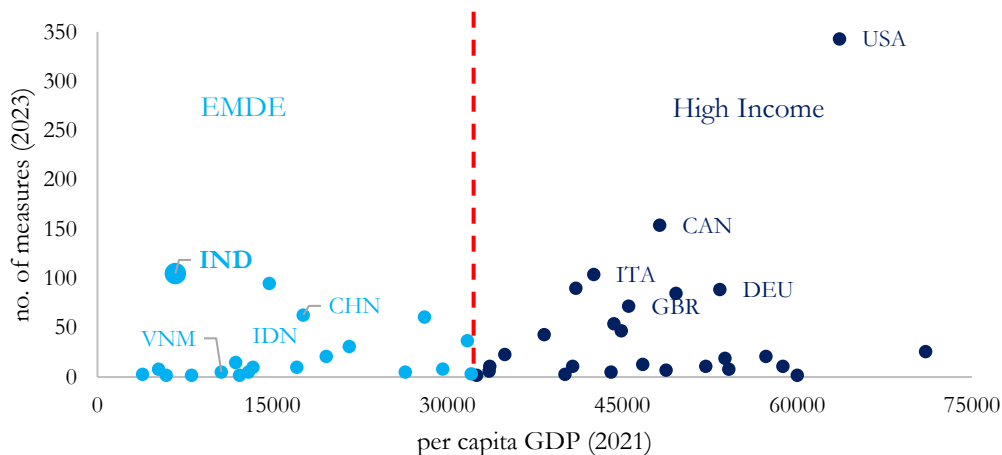
## 4. India's trade opportunities in a changing global context

### a. India's Path to Greater Trade and Global Value Chain Participation in a Challenging Global Context

**The global backdrop is challenging...**

The global backdrop is characterized by significant geopolitical risks and a general rise in protectionism. Although global trade is rebounding, with a projected 2.6 percent growth in the volume of merchandise trade in 2024 and expected growth of 3.3 percent in 2025, risks to this forecast are significant. They include geopolitical tensions, policy uncertainty and a rise in protectionism (WTO 2024). In recent years, trade linkages and supply chains have been shown to be highly vulnerable to geopolitical and other disruptions. At the same time, a global trend towards protectionist economic policies has gained momentum, with many nations increasingly adopting trade distorting measures. For example, almost 3,000 new trade-distorting measures were imposed in 2023, three times as many as in 2019<sup>36</sup> (Global Trade Alert, 2024). A significant proportion of these trade-distorting measures took the form of industrial policy, with the most active practitioners including the US, China, India, and most of the EU economies (Figure 4.1).

**Figure 4.1: Trade Distorting Measures - Global Context**  
(X axis: per capita GDP (2021); Y axis: no. of measures (2023))



Note: EMDE=Emerging Market and Developing Economy  
Source: Global Trade Alert, 2024.

**...but there are opportunities for India to leverage**

Heightened perceptions of geopolitical risks have prompted companies to diversify their sourcing strategies. This presents an opportunity for countries like India with an abundant workforce and a growing manufacturing base. To make the most of these new opportunities, however, India's trade policy must be supportive.

<sup>36</sup> The Global Trade Alert database covers measures such as export and import policy instruments (tariffs, quotas, bans, subsidies, etc.), capital controls and exchange rate policy, foreign investment policy, migration policy, localization policy, public procurement policy, subsidies and state aid, trade defense instruments, and other instruments such as intellectual property protection, sanitary and phytosanitary measures, and technical barriers to trade. (GTA Handbook, 2022).



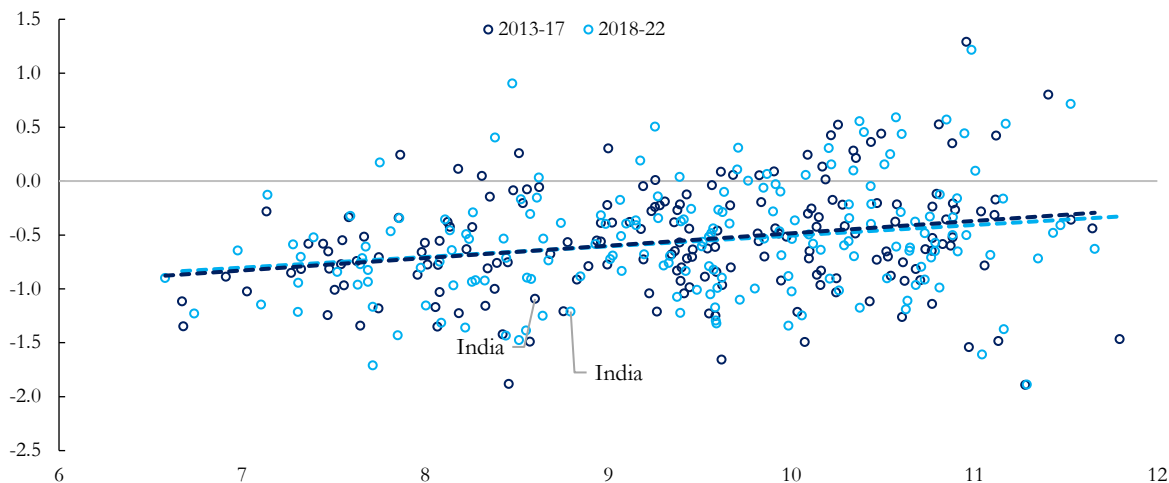
**On trade, India is punching well below its weight**

Despite its rising economic heft, India's trade in goods and services has been declining as a percentage of GDP over the last decade, and it is lower than in countries at similar stages of development (Figure 4.2).

**Figure 4.2: Trade Openness, 2013-2022**

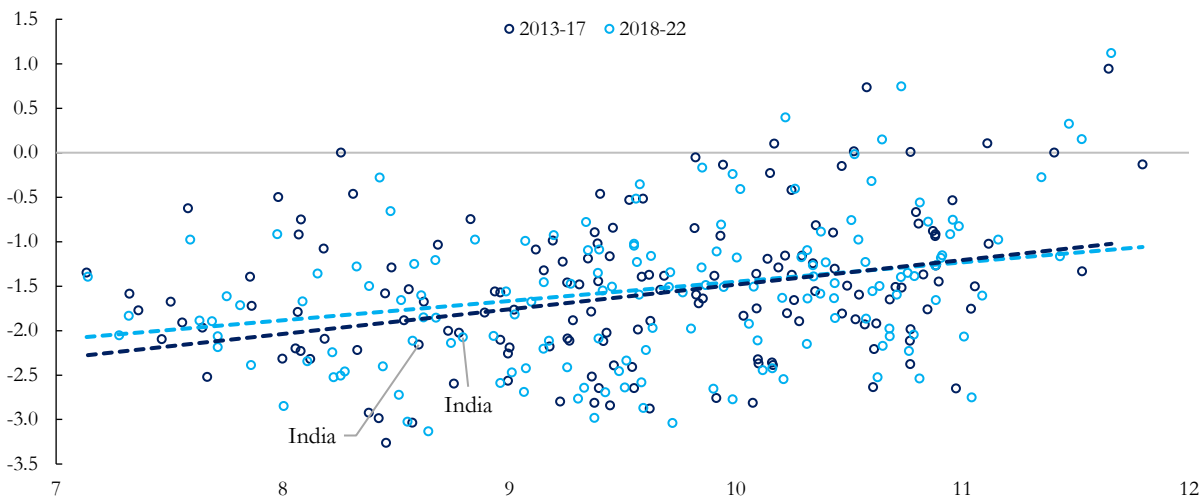
**A. Adjusted Trade Openness (Goods)**

(X axis: log per capita GDP (\$, 2017, PPP); Y axis: log of goods trade to GDP ratio)



**B. Adjusted Trade Openness (Services)**

(X axis: log per capita GDP (\$, 2017, PPP); Y axis: log of services trade to GDP ratio)



Source: WITS 2024 Note: Log of openness to trade (goods and services) plotted against log of GDP per capita, controlling for the effect of population size. The sample contains all countries with available data in WITS for 2013–22 (the graph shows period averages for 2013/17 and 2018/22). WITS = World Integrated Trade Solution.

**India's exports have evolved in recent years, but more can be done to push intensive and extensive margins**

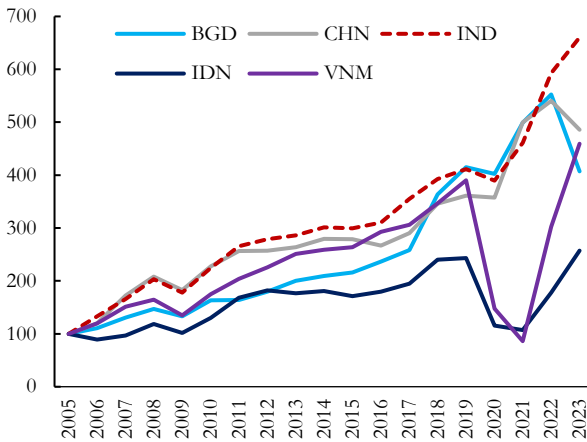
The composition of India's exports has changed over the past decades. Services exports growth has significantly outpaced merchandise exports growth (Figure 4.3), led by telecom services, including computer and information services, and other business services (which together account for over two-thirds of the India's services exports - IMF BOP 2023). Still, in 2022 India caters to just 4.3 percent of global services demand and there is significant potential for further growth: in 2022, India had a strong revealed comparative advantage (RCA) in telecommunication, computer, and information services as well as in other business and transport services (RBI, 2024). Within goods exports, in

addition to gems and petrol, skill-intensive products of moderate complexity —such as engineering and transport equipment and pharmaceuticals— have gained in importance (WITS 2024). However, to achieve its merchandise export target of USD 1 trillion by 2030 (from USD 435 billion in FY23/24), India will need to diversify its export basket even further and enter new markets. That would bring added benefits in terms of (i) risk diversification, by reducing reliance on traditional markets, which may face slower growth or protectionist measures, as well as (ii) opportunities for innovation and productivity growth.

**Figure 4.3: India’s export growth**

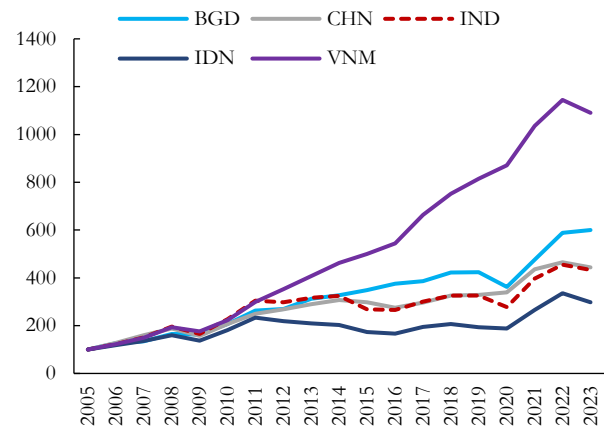
**A. Growth in services exports**

*(y-o-y, indexed at 2005=100)*



**B. Growth in goods exports**

*(y-o-y, indexed at 2005=100)*



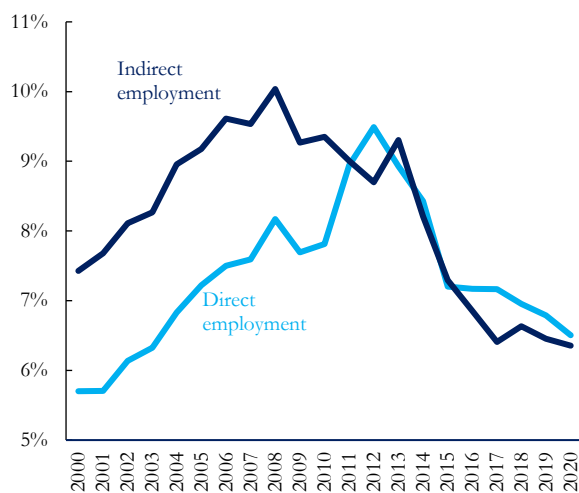
Source: WTO, 2023 are estimates.

**India’s exports are relatively capital intensive**

Direct employment related to exports has fallen from a peak of 9.5 percent of total domestic employment in 2012 to 6.5 percent in 2020. There was a similar trend in indirect employment, which peaked at 9.6 percent in 2006 and then fell to 6.4 percent by 2020<sup>37</sup> (Figure 4.4). This is because India's exports have increasingly consisted of skill-intensive manufacturing and services (Figure 4.5). Because these sectors are highly capital-intensive, they are ill-suited to employ large shares of the Indian workforce (Rodrik et al., 2017).

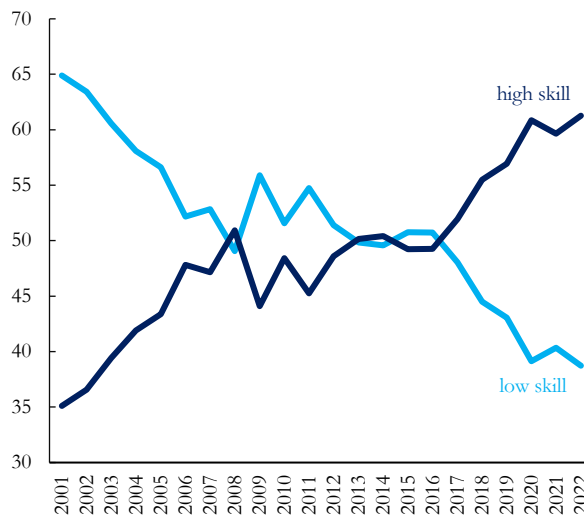
<sup>37</sup> Re-imported employment contributed minimally, maintaining around 1% to 2% throughout the period.

**Figure 4.4: Jobs created by exports-related activities in India, 2000-2020**  
(percent of domestic employment)



Source: OECD Trade in employment 2023.

**Figure 4.5: India's High and Low Skill-intensive Manufacturing**  
(percent of total manufacturing exports)



Source: UN Comtrade, WB staff calculations.

#### Box 4.1: Gains from trade diversification, upgrading and deeper GVC participation

Trade diversification can enhance a country's economic resilience and growth prospects. By expanding into new sectors and markets, countries can reduce their vulnerability to fluctuations in demand and prices. Diversification also opens new avenues for growth, creating more and better jobs and fostering innovation across various sectors.

Upgrading within existing industries and GVCs can further augment these benefits. Upgrading may involve enhancing technological capabilities, improving product quality, and adopting more sophisticated production processes, while GVC upgrading entails moving into higher-value activities within the global production network. Upgrading can increase a country's share of value-added and capture greater gains from international trade, facilitated by knowledge and technology transfers.

Deepening GVC participation involves increasing the number and diversity of GVCs a country participates in, expanding the range of activities and tasks undertaken within those GVCs, and forging stronger linkages with other firms and countries in the network. This deeper integration facilitates knowledge and technology transfer, enhances productivity and competitiveness, and can lead to sustained economic growth, improved living standards, and greater resilience to external shocks.

#### Greater trade diversification, upgrading and deeper GVC

A multi-pronged approach focusing on trade diversification, upgrading<sup>38</sup> and deeper integration into GVCs would boost job creation and productivity growth (Box 4.1). Diversification can be achieved by expanding into more labor-intensive sectors such as textiles, apparel, leather, and footwear, which have traditionally generated substantial

<sup>38</sup> Upgrading of exports refers to the process of shifting towards higher value-added products and services within existing industries or moving into entirely new sectors with greater growth potential. This often involves enhancing technological capabilities, improving product quality, and adopting more sophisticated production processes. Upgrading within GVCs entails a similar shift, where firms or countries move towards higher-value activities within the global production network, such as design, research and development, or marketing. Both export upgrading and GVC upgrading are crucial for countries seeking to increase their competitiveness, capture larger shares of global markets, and achieve sustainable economic growth.

**integration would boost job creation and long-term growth**

employment, particularly for women. India could focus specifically on higher value-added segments of textiles and apparel, including through GVC participation. Additionally, India could seek to upgrade into sectors with high future potential, such as environmental goods and services<sup>39</sup>. Simultaneously, deeper integration into GVCs would enable India to enhance technological capabilities and productivity across various sectors of the economy. This, in turn, would foster long-term economic resilience, growth and more jobs.

**Labor-intensive sectors such as textiles, apparel, leather, and footwear are important for job creation**

In 2020, capital-intensive sectors<sup>40</sup> accounted for 70 percent of manufacturing GVA and 50 percent of formal manufacturing job in India. In contrast, labor-intensive sectors, such as apparel and textiles, which account for less than 20 percent of formal manufacturing GVA, were responsible for over 40 percent of formal manufacturing jobs. These labor-intensive activities present vast opportunities for job growth, particularly for women (33 percent of workers in the apparel and textile sectors are female, compared to only 15 percent in non-textile and non-apparel manufacturing). Increased textile and apparel exports played a key role in creating approximately 800,000 formal jobs between 1999 and 2011.

**As China withdraws from low-skill manufacturing due to increasing wages, India has the potential to capitalize on this opportunity.**

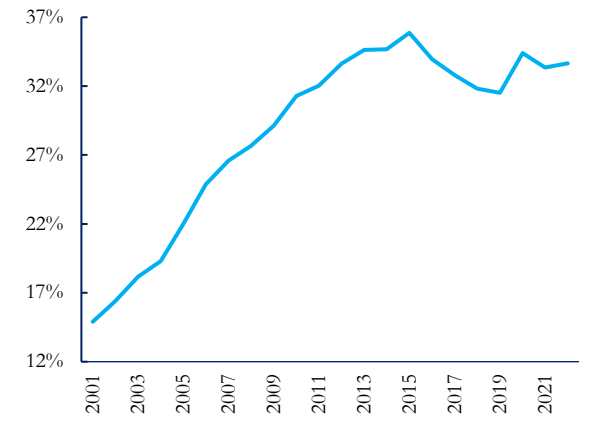
As China's participation in low-skill manufacturing decreases, due to rising wages, India can do more to capitalize on this opportunity (Figure 4.6). Currently, countries such as Bangladesh and Vietnam, and even advanced economies such as Germany and the Netherlands, have become the primary beneficiaries of China's shrinking market share (Figure 4.7). India's share in global exports of Apparel, Leather, Textiles, and Footwear (ALTF) initially grew from 0.9 percent in 2002 to a peak of 4.5 percent in 2013, but it subsequently declined to 3.5 percent in 2022. In contrast, Bangladesh and Vietnam have achieved strong growth, with Bangladesh reaching 5.1 percent and Vietnam 5.9 percent of global ALTF exports in 2022. (Figure 4.7).

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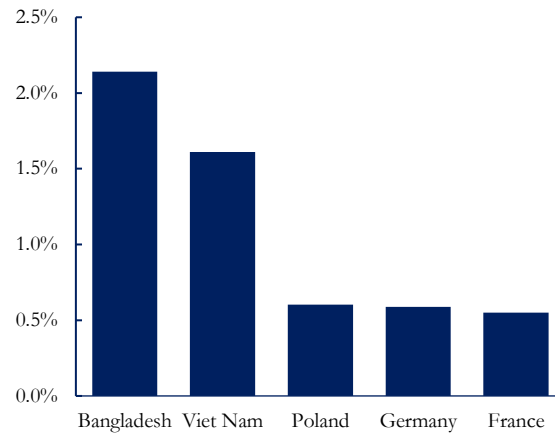
<sup>39</sup> There is no universally accepted list of environmental goods (EG) at this stage. Three major lists are used to understand and facilitate trade in EGs: the WTO list, which includes 411 products from member submissions between 2002 and 2005; the OECD list, with 132 products that categorize the environmental industry into pollution management, clean technologies, and resource management; and the APEC list, consisting of 54 products that are more commonly accepted for trade liberalization. These lists, though not officially adopted in WTO negotiations, are being used for ongoing discussions and negotiations. Environmental services (ES) cover both infrastructural services, such as energy generation and waste management, and non-infrastructural services, like air pollution control and site remediation. These services typically involve installation, maintenance, and monitoring, relying on both domestic expertise and international technicians and engineers.

<sup>40</sup> Capital and labor-intensive classification is based on the capital-labor ratio (K/L) estimated using the 2021-22 round of Annual Survey of Industries. The K/L ratio has been estimated at the 2-digit NIC-2008 sectors. Top 10 sectors with high K/L ratio are considered to be capita-intensive and bottom 10 sectors are labor intensive.

**Figure 4.6: China's Diminishing Share in Global Textile, Apparel, Leather and Footwear Exports (percent)**

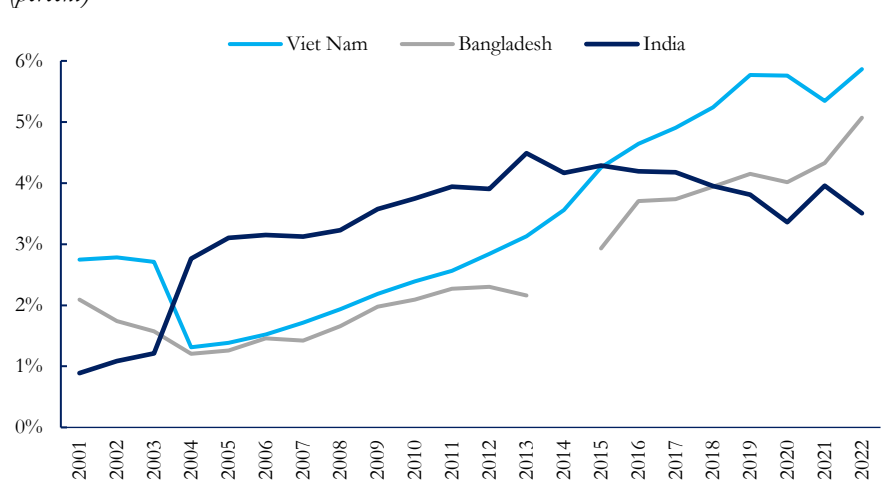


**Figure 4.7: Top Five Beneficiaries of China's Loss in Global Exports Share in low skill sectors (2015-22) (gain in global exports share, percent)**



Source: UN Comtrade, WB staff calculations.

**Figure 4.8: Share in Global Apparel, Leather, Textiles, and Footwear (ALTF) Exports, India and selected comparators (percent)**

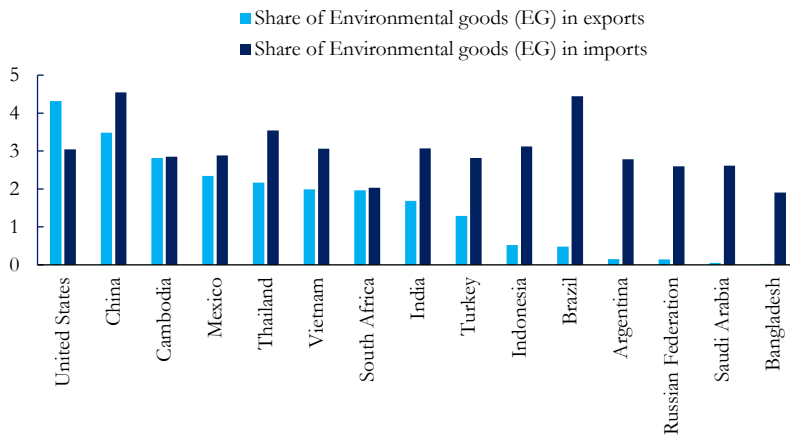


Source: UN Comtrade, WB staff calculations.

**Greening trade can speed up export diversification and growth for India**

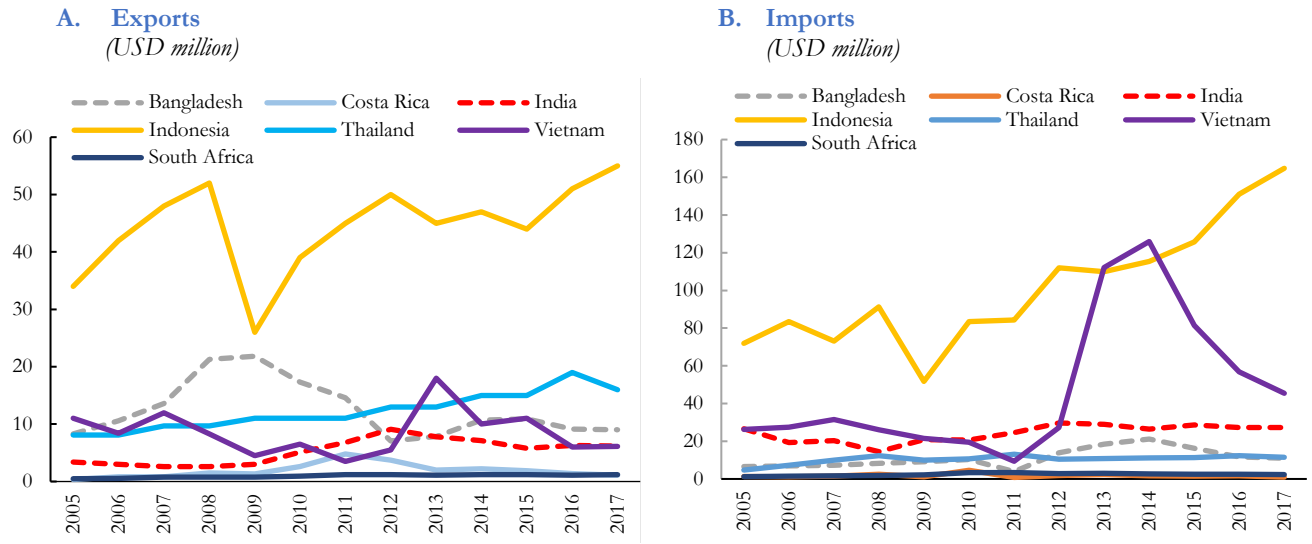
Additional focus on exports of Environmental Goods and Services (EGS) could further boost trade diversification and upgrading (Figure 4.9 & Figure 4.10). EGS can be a channel to diversify exports while prioritizing environmental protection, social responsibility, and economic viability throughout the entire supply chain (by adopting sustainable practices, from green production and sourcing to efficient transportation and eco-friendly packaging). With the increasing global demand for low-carbon goods and services, India can capitalize on the opportunity by investing in clean technology, promoting sustainable production and consumption, and implementing policies to reduce GHG emissions.

Figure 4.9: India's participation in environmental goods



Source: WB staff calculations

Figure 4.10: India's environmental services exports are lagging behind comparators



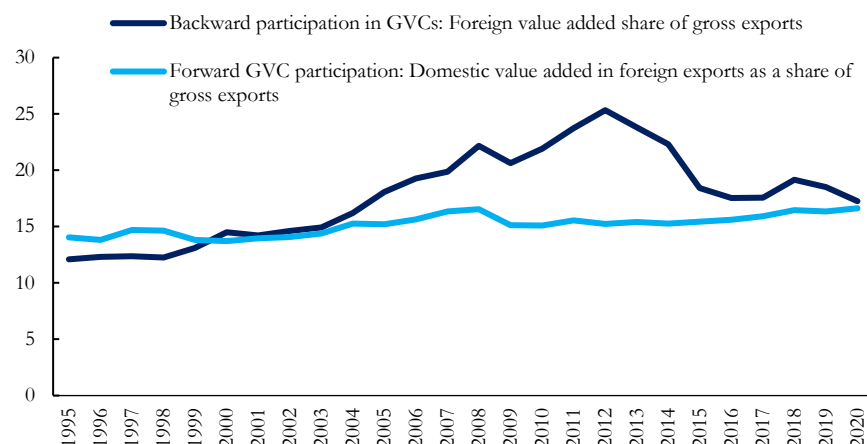
Source: WTO TIMOS

**India is not leveraging GVCs to their full potential**

Although GVCs<sup>41</sup> offer a strategic solution to diversify trade and enhance competitiveness, India is not fully leveraging this opportunity. By integrating into GVCs, India can: (i) expand the variety of what it produces (by participating in the production of higher-added value goods), (ii) enhance its competitiveness (by gaining access to advanced technologies and global markets), and (iii) increase flows of FDI by multinationals seeking to produce in India. Currently, India's participation in GVCs is relatively limited. Backward participation, where exports incorporate foreign inputs, peaked at over 25 percent of gross exports around 2010 before declining to about 15 percent by 2020. Forward participation, where India provides inputs for other countries' exports, remained relatively stable between 10 percent and 15 percent from 1995 to 2020, with minor fluctuations around the 2008 financial crisis and after 2011. The decline in backward participation highlights the importance of removing barriers on intermediate inputs (Figure 4.11).

<sup>41</sup> GVC firms are those that export any product in a given year and import all products/products classified as intermediate inputs.

**Figure 4.11: India's diminishing participation in backward GVCs**  
(value add share of gross exports)



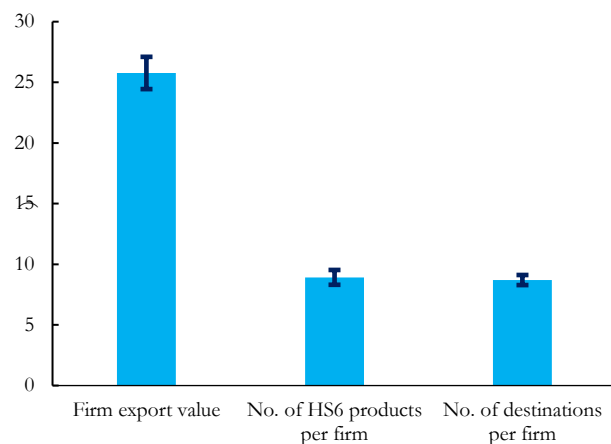
Source: OECD Trade in employment 2023.

**Indian firms have not been able to leverage GVCs**

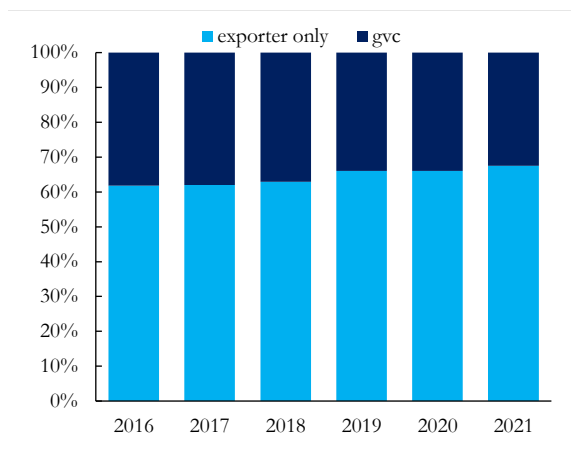
Firm-level data shows that Indian exporters with GVC linkages exhibit stronger export performance and greater product and market diversification compared to exporting firms that don't participate in GVCs (Figure 4.12A). However, India's participation in GVCs has been declining over the past five years (Figure 4.12B). This is likely due to a combination of factors, including enduring infrastructure and logistical limitations, gaps in technology and skills, and policy uncertainty (especially policy reversals).

**Figure 4.12: GVCs and exporters, gains and participation**

**A. Gains from integrating GVCs for Indian firms**  
(increase due to firm's integration in GVC, percent)



**B. Exporters vs GVCs**  
(percentage)



Note: GVC firms both import and export goods, while exporters only export goods without importing anything.  
Source: India Customs data, Panjiva 2022

**b. India's Trade Balancing Act: Progress and Protectionism**

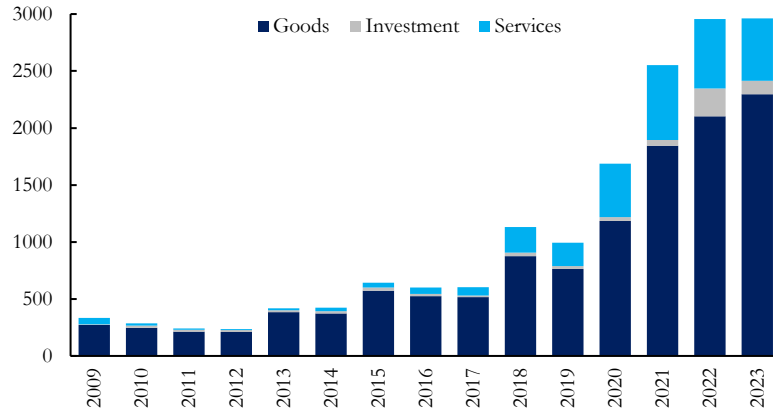
**India's recent trade policies include progressive elements and protectionist measures**

India's recent trade policies exhibit a mix of positive developments and lingering challenges. On the positive side, the government has implemented the National Logistics Policy (NLP) and various digital initiatives aimed at reducing logistics costs, thus addressing a major competitive hurdle for Indian exports. Additionally, India has actively engaged in the global trading system through the signing of new Free Trade Agreements (FTAs) with countries like the United Arab Emirates (UAE), Australia and the European Free Trade Association



(EFTA) states. At the same time, India has significantly scaled up its use of protectionist measures such as increased tariff and non-tariff barriers, as well as industrial policies affecting trade in goods and services (Figure 13).

**Figure 4.13: India's trade distorting measures**  
(number of interventions)

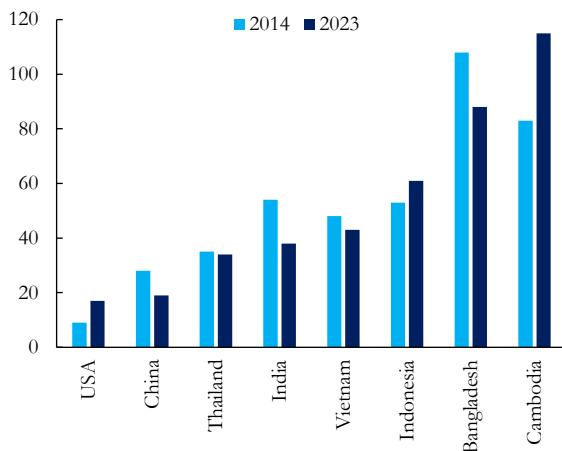


Source: Global Trade Alert, 2024.

**India has proactively improved logistics and trade facilitation...**

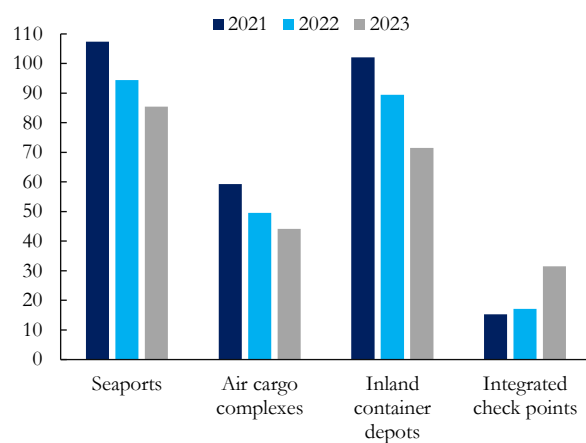
India's NLP seeks to substantially reduce logistics costs, bringing them in line with global averages, and prioritize digital technologies for efficiency. India's progress is captured by the World Bank's Logistics Performance Index, wherein India has risen to 38th position in 2023 (Figure 4.14). Additionally, the work of the National Committee on Trade Facilitation (NCTF) has shown consistent progress in reducing import release times<sup>42</sup> (Figure 4.15).

**Figure 4.14: LPI ranking for India and selected comparators**  
(rank)



Source: World Bank LPI, 2024

**Figure 4.15: Import release time**  
(hours)



Source: National Committee on Trade Facilitation (NCTF) 2024

**... however, there is a resurgence of protectionism**

Tariff and non-tariff barriers are increasingly impacting India's participation in international trade. The WTO Tariff Profile for 2022 shows an increase in India's import tariffs, with the average Most Favored Nation (MFN) tariff rising to

<sup>42</sup> Import release time refers to the time taken to process and clear goods through customs so they can be brought into a country.

18.1 percent from 17.6 percent in 2019 and 13.4 percent in 2016. Since 2017, India seems to have reversed the reduction of tariff barriers initiated in the early 1990s, and it now has import tariffs that are higher than those of comparator countries (Figure 4.16 A). While there have been some customs duty reductions, increases have been enforced on various goods: for instance, tariffs on raw materials and consumer goods have decreased slightly, but import duties rose on intermediate inputs and capital goods (Figure 4.16 B).

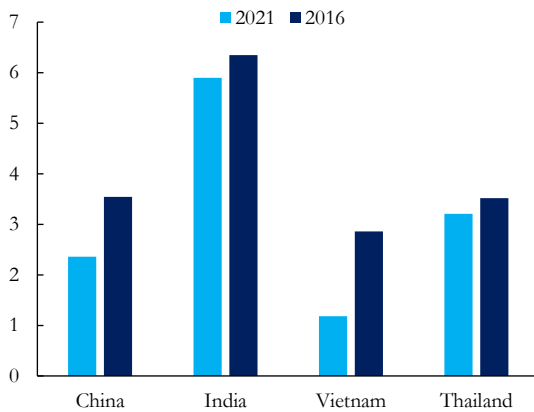
**The FY24/25 budget proposed positive measures, which could be taken further**

The FY24/25 budget proposes tariff reductions on various items, including medical equipment, mobile phones and related parts, critical minerals, solar energy products, marine products, leather and textiles, precious metals and other metals, electronics, petrochemicals, and telecom equipment. The reduction of customs duties applicable to labor-intensive sectors is also significant, intended to boost exports and address the inverted duty structure that hampers manufacturing. While these tariff reductions are positive, they could be further enhanced by a strategy to reduce tariffs across the board, which would eliminate possible tariff disparities and reduce costs for imported intermediate inputs, particularly in capital-intensive industries that are also relevant to raw materials and labor-intensive sectors. Box 4.2 outlines India’s tariffs and industrial policies in selected sectors.

**Figure 4.16: India’s import tariff profile**

**A. Trade-weighted average applied import tariff India and comparators**

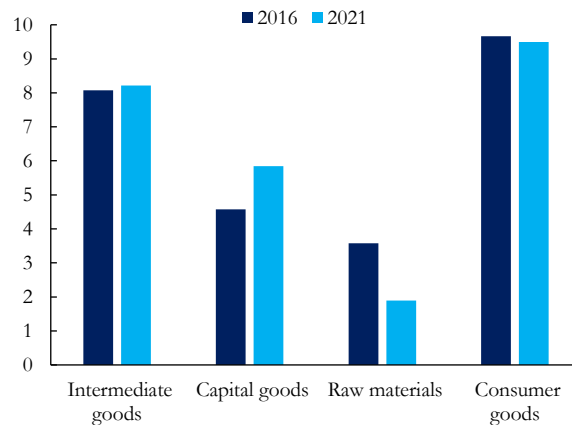
(percent)



Source: WITS

**B. Trade-weighted average applied import tariff India by stage of processing, percent**

(percent)

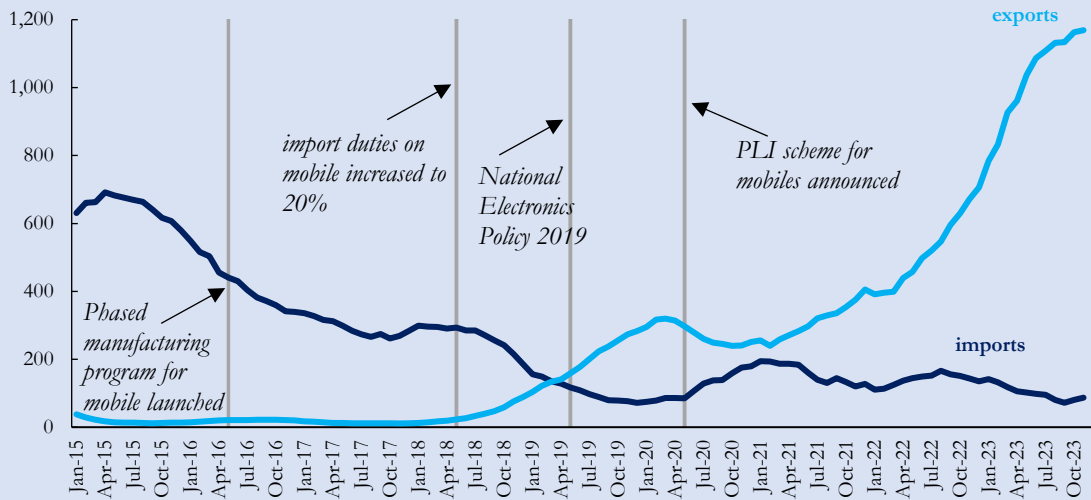


Source: WITS

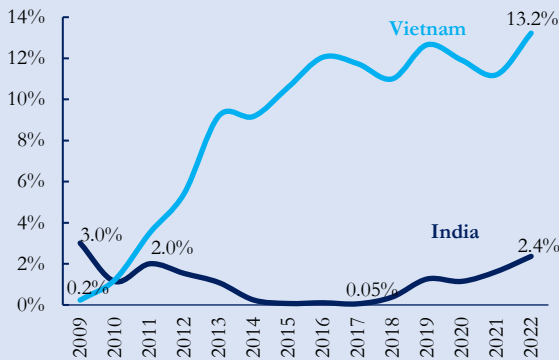
**Box 4.2: Reevaluating India’s tariffs and industrial policies to sustain growth and competitive edge in global markets**

**High import tariffs decrease the competitiveness of manufacturing and limit exports of both high- and lower-skilled sectors.** The Indian government has implemented several policy initiatives aimed at revitalizing the mobile phone manufacturing sector, including the Phased Manufacturing Plan (2016), increased import tariffs on mobile phones (2018), the National Electronics Policy (2019), and the Production Linked Incentives (PLI) scheme (2020). These policies are designed to attract investment, enhance local manufacturing capabilities, create jobs, and reduce the trade deficit by incentivizing firms to produce mobile devices and components within India. However, recent hikes in import tariffs on key intermediary inputs, which brought average tariffs from 4% to 18% between 2018 and 2021, threaten the sector’s competitiveness against lower-tariff countries like China and Vietnam. While global firms such as Samsung and Apple have managed to mitigate these increases through duty drawback schemes, domestic manufacturers face higher costs and barriers to entering the export market.

**Figure B2.1: India has become a net exporter of mobile phones as exports have surged amid falling imports**  
(USD mn, 12 months rolling average)



**Figure B2.2: India’s global share in mobile exports has improved but remains modest**  
(share to global mobile phone exports, percentage points)



**Figure B2.3: Mobile manufacturers in India are facing high tariffs on key inputs**  
(average ad-valorem duty for MFN, percent)



Source: UNCOMTRADE, WITS and WB Staff calculations

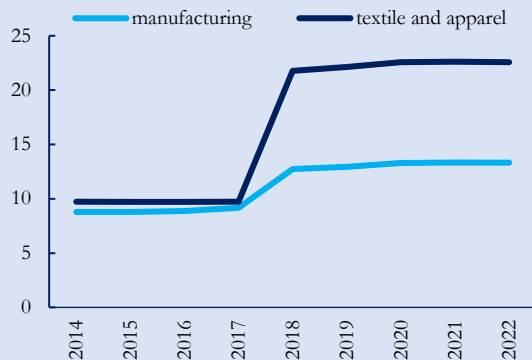
Note: HS codes 851712-14 have been used for mobile phones. Key mobile phone intermediary inputs include HS codes 8517710, 8517790, 854140, 850440, 853400.

Since 2017, average MFN tariff in the textile and apparel sector have gone up by 13 percentage points (Figure B2.4). These tariff hikes not only apply to final goods, but also the intermediate inputs that go into the production process (Figure B2.5). Therefore, both domestic producers and consumers face higher prices. Consequently, the productivity of the sector has declined, in particular among the relatively more productive firms (Figure B2.6). The labor productivity of firms in the top 10 productivity percentile declined by nearly 8 percent between 2017 to 2022 (while other firms saw their productivity rise)<sup>43</sup>. This is linked to the fact that the most productive firms tend to use more of cheaper imported inputs and suffer more from increased import tariffs.

With rising costs of production and declining productivity, India’s share in global apparel exports has declined from 4.0 percent in 2018 to 3.0 percent in 2022, precisely when China has been ceding export space (Figure B2.7). During the same period, India’s global competitors have significantly increased their market share.

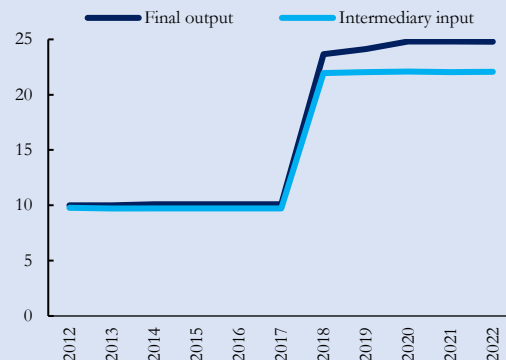
**Figure B2.4: Import tariff for the garment sector has increased since 2017**

(MFN tariff, percent)



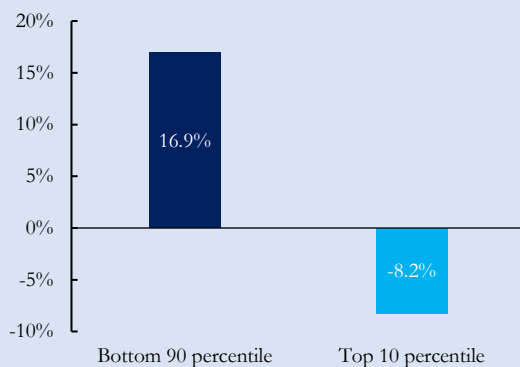
**Figure B2.5: Import tariff for intermediary inputs have increased as well**

(average ad-valorem duty for MFN, percent)



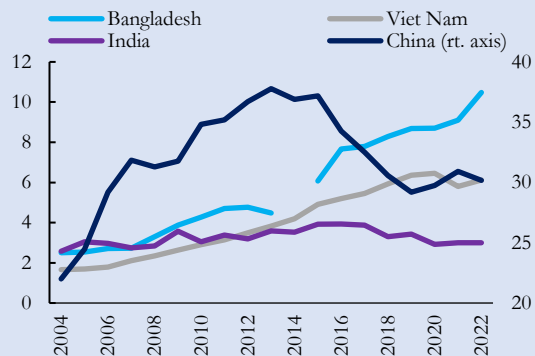
**Figure B2.6: Productivity has declined driven entirely by most productive firms**

(change in per worker output (2018-22), percent)



**Figure B2.7: India has been losing in the global apparel exports market**

(global exports share, percent)



Source: WTO, UN Comtrade, WB staff calculations.

<sup>43</sup> In absolute terms, the average productivity of the top 10 productivity percentile firms is significantly higher than that of the bottom 90 productivity percentile. As a result, the productivity decline in the top 10 productivity percentile firms outweigh the productivity gains in the bottom 90%.

**India extensively employs non-tariff barriers that add to trade cost**

India extensively employs non-tariff barriers. These measures include anti-dumping, technical barriers to trade (TBT), and arguably excessive or unnecessary sanitary and phytosanitary (SPS) measures, which restrict imports and increase costs of production. In sectors like agriculture these restrictive factors are compounded by policy uncertainty (such as when the government imposes or lifts export and import bans). In general, NTBs increase trade costs, inefficiencies in border processes and red tape.

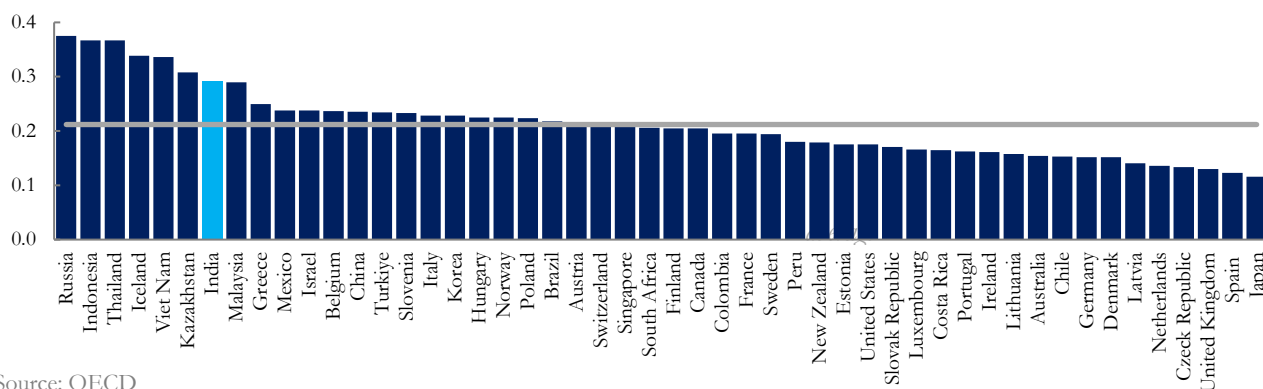
**India's services trade policies are comparatively restrictive**

According to the OECD's 2023 Services Trade Restrictiveness Index (STRI) report for India, restrictions on foreign entry and operations of foreign service providers in India's service sector are higher than the OECD average and high relative to most countries in the STRI sample (Figure 4.17 A). Limitations on foreign ownership, labor market tests, and public monopolies constrain sectors like rail freight transport, legal services, distribution, and banking (Figure 4.17 B).

**Figure 4.17: Services Trade Restrictiveness Index**

**A. Overall STRI India and comparators**

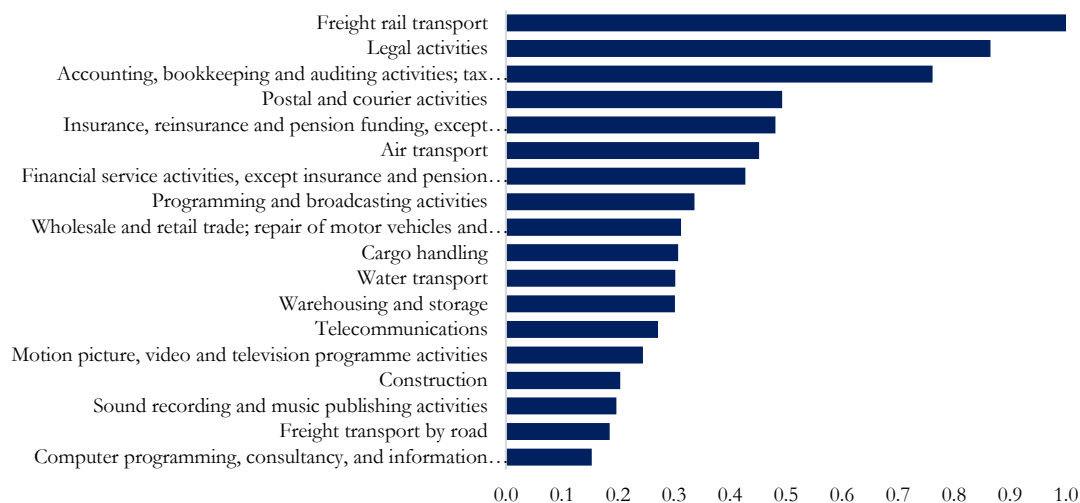
(index, 2023)



Source: OECD

**B. India STRI by sector**

(index, 2023)



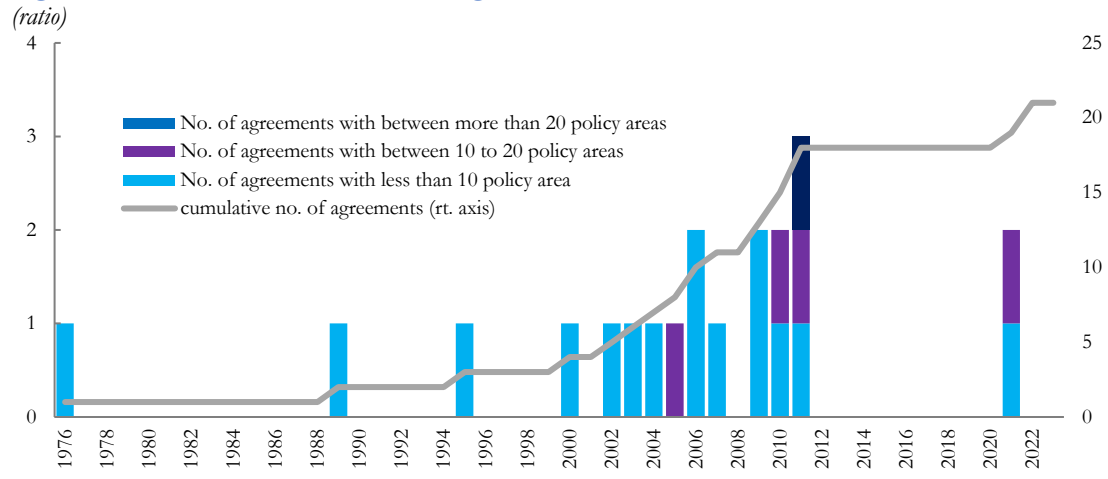
Source: OECD

**India has re-engaged on FTAs**

India's traditional approach to free trade agreements (FTAs) has been one of gradual engagement. Following a surge in agreements from 1990 to 2012, there was a notable slowdown in new pacts from 2014 to 2022 (Figure 4.18). However, recent FTAs with the

UAE, Australia, and EFTA signal renewed interest. These agreements aim to reduce tariffs, boost bilateral investments, and create jobs. Notably, the proportion of India's exports covered by FTAs is lower than its import coverage, which contributed to the considerably lower GDP impact of Deep Trade Agreements (DTAs)<sup>44</sup> than the export impact, suggesting a strategic aim of securing more favorable market access terms (Figure 4.19 Panel A and B).

**Figure 4.18: Number of FTAs and coverage ratio**

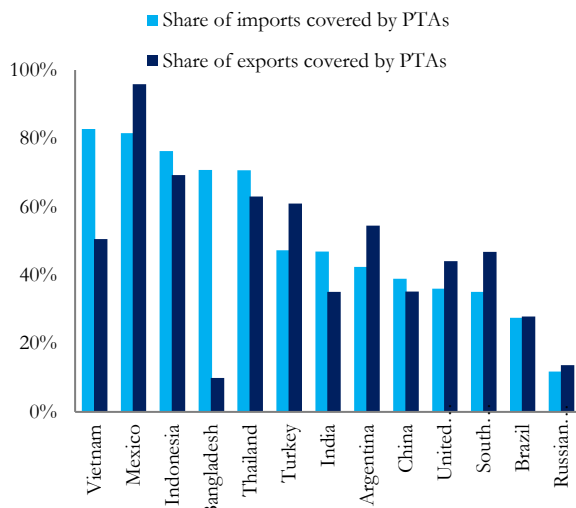


Source: World Bank DTA, 2024

**Figure 4.19: Deep Trade Agreements**

**A. Integration Intensity**

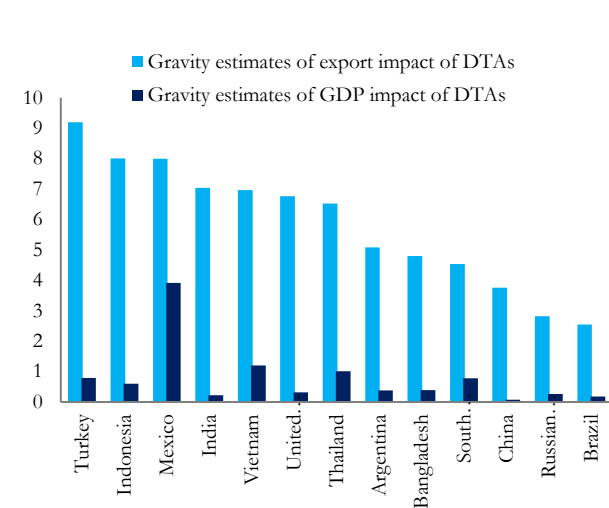
(share)



Source: World Bank DTA, 2024

**B. Impact of Deep Trade Agreements**

(percentage change)



Source: World Bank DTA, 2024

**However, some of the new FTAs exclude key areas**

While these new FTAs represent a positive step, there are limitations. For example, the India-EFTA Trade and Economic Partnership Agreement (TEPA) excludes key areas such as digital trade, e-commerce, pharmaceuticals, and MSMEs, which potentially limits

<sup>44</sup> Deep Trade Agreements are reciprocal agreements between countries that cover not just trade but additional policy areas, such as international flows of investment and labor, and the protection of intellectual property rights and the environment. While these agreements are still referred to as trade agreements, their goal is integration beyond trade or deep integration (World Bank Deep Trade Agreements project).

**that potentially limit their overall impact** its overall impact (see Box 4.3). Moreover, India does not participate in mega trade blocs such as the Regional Comprehensive Economic Partnership (RCEP) despite potential benefits from greater market access (see Box 4.4).

#### **Box 4.3: Assessing India's Trade and Economic Partnership Agreement (TEPA) with the European Free Trade Association (EFTA)**

India's Trade and Economic Partnership Agreement (TEPA) with the European Free Trade Association (EFTA), finalized on March 10, 2024, is the result of an extensive 16-year negotiation. TEPA aims to enhance bilateral investments and foster the creation of one million direct jobs within India. However, the agreement's scope is narrower than that of India's other FTAs, particularly those with the UAE, and prospective agreements with the UK and EU; TEPA omits critical sectors such as digital trade, e-commerce, pharmaceuticals, and MSMEs. Furthermore, it lacks stringent enforcement and dispute resolution mechanisms.

The agreement offers tariff reductions in selected product categories and introduces measures to enhance access to India's market for EFTA service providers. This includes the establishment of mutual recognition agreements (MRAs) for professional services, and an Intellectual Property Rights (IPR) chapter that propels the ratification of additional vital IPR treaties.

Yet, TEPA faces potential challenges that may undercut its efficacy. The absence of 'WTO-plus' commitments, especially regarding sanitary and phytosanitary (SPS) measures and technical barriers to trade (TBT), may curtail the depth of integration and trade facilitation envisaged. Moreover, the restricted regulatory commitments outlined in the agreement could impose ongoing compliance burdens on exporters, stifling the diversification and expansion of trade relations. These challenges could limit the agreement's impacts in generating jobs and mitigating trade deficits. Future policy reforms and a possible widening of the agreement's ambit will help realize its full potential.

#### **Box 4.4: Expected implications of India opting out of RCEP**

India opted out of RCEP in 2019, citing the worry of "non-transparent" competition and a potential increase in trade deficits as the main reasons.

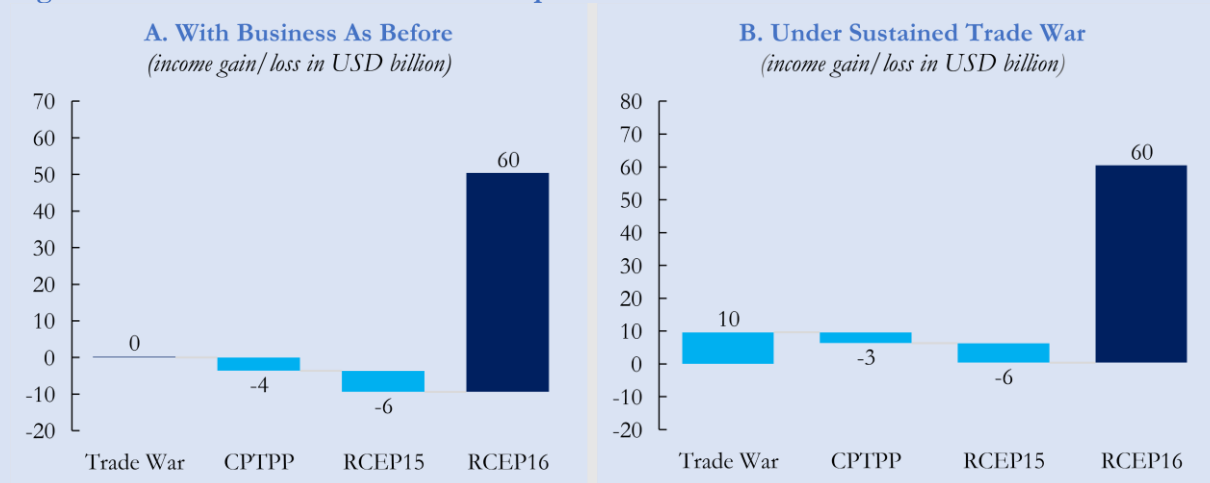
Analysts have tried to evaluate the impact of participating in or pulling out of mega trade deals using general equilibrium models. The conclusion of the most widely cited study ([Petri and Plummer, 2020](#)) suggests that India would gain USD 60 billion by 2030 if it joined RCEP. Aggregate income gains from RCEP16 would be shared across all of India's major economic sectors (raw materials, light manufacturers, advanced manufactures, domestic services and traded services). Export gains would range from approximately 4 percent for (primarily) domestic services to 17 percent for traded services (e.g., in computing, finance, marketing) (Figure 2).

Petri and Plummer (2020) show that RCEP15 (without India) will add USD 186 billion to the world economy and 0.2 percent to its members' GDP on a permanent basis. These benefits will go largely to China, Japan, and Korea, with gains of USD 85 billion, USD 48 billion, and USD 23 billion, respectively. Other significant RCEP15 winners include Indonesia, Malaysia, Thailand, and Vietnam. Results show that India's income will increase by USD 60 billion annually if it rejoins the agreement (RCEP16) and will fall by USD 6 billion if it does not. By contrast, China is poised to become the largest beneficiary of RCEP15, with greater gains in the current trade war environment (with gains of USD 100 billion) than if there were no trade war (USD 80 billion) (Figure B4.1).

Trade diversion could harm India's exports to RCEP members. Preference margins accorded within the bloc to the other signatories that can generate supply chain realignments or increased competition from RCEP signatories.



**Figure B4.1: India Income effects of trade policies**



Note: RECP 15= RCEP without India, RCEP 16= RECP with India  
 Source: Petri and Plummer (2020)

<sup>141</sup> Petri and Plummer (2020), East Asia Decouples from the United States: Trade War, COVID-19, and East Asia’s New Trade Blocs. Peterson Institute for International Economics Working Paper 20-9.

**c. Trade Policy Priorities: Reducing Costs, Lowering Barriers, and Re-strategizing Participation in FTAs**

**India could consider a new strategic trade plan to diversify exports and leverage the changing geopolitical landscape**

Shifting geopolitical, demographic, and environmental realities, call for a new strategic trade roadmap. If India wishes to leverage its strengths and appeal as a business-friendly alternative (or complement) to China, it should ideally double down on: (i) continuing to reduce the trade cost and improve facilitation to boost export competitiveness; (ii) reducing trade barriers, such as tariff and non-tariff barriers and service restrictions; and (iii) reevaluating trade integration approaches, including India’s position on RCEP, given the potential benefits of greater plurilateral and multilateral cooperation.

**India can reduce trade costs and continue improving trade facilitation to boost export competitiveness**

A comprehensive approach to reduce trade costs and improve trade facilitation can be achieved through ongoing reforms aimed at simplifying and streamlining customs procedures, increasing transparency and predictability in regulations and policies, and reducing bureaucratic red tape. For example, simplifying and automating customs procedures through digital platforms can reduce clearance times and increase efficiency. Improving infrastructure at ports and logistics hubs will help streamline the movement of goods, while establishing single-window clearance systems will minimize bureaucratic delays. Enhancing transparency by providing accessible, up-to-date information on trade regulations and tariffs can support businesses in compliance. Strengthening regulatory coordination among agencies will ensure consistency and predictability in trade processes, fostering a more conducive environment for international trade.

**Reducing trade barriers and domestic impediments would promote diversification and deepen GVC participation**

Reducing tariff and non-tariff barriers, relaxing services restrictions, and increasing the predictability of trade policies are fundamental steps to boost competitiveness in both goods and services sectors. Policies that help exporting firms access imported intermediate goods and services would significantly improve their performance. Empirical evidence for India, Bangladesh, and China suggests that access to imported inputs helps promote product diversification and productivity of domestic firms (Kee, Forero, and Fernandes 2021). Trade promotion policies include tariff and value-added tax reductions and duty drawbacks on imported materials and expanded access to trade financing,

particularly for small exporting firms. Rationalizing tariffs on intermediary inputs is crucial for labor-intensive sectors. These reforms can create a conducive environment for foreign as well as domestic investments, increasing access to capital goods (such as machinery and equipment) essential for upgrading the production process and participating in GVCs. India's trade opportunities could be further expanded by integrating rural products and services into global value chains through support for small-medium enterprises, promotion of organic and sustainable agriculture, and enhancing market access for rural artisans.

**India could  
reconsider regional  
integration options**

Assessments of regional integration scenarios show that the highest gains come from comprehensive integration scenarios that include trade facilitation, services, and FDI. This means that in addition to reducing tariffs and other trade barriers, India should focus on improving the ease of doing business and reducing barriers to trade in services and FDI. India's recent focus on bilateral FTAs with Australia, the UAE, the US, the UK, and the European Union is a step in the right direction, as these FTAs aim to secure greater market access for goods and services as well as high-quality imports. However, the impact from these new FTAs remains to be determined. For example, the India-EFTA Trade and Economic Partnership Agreement (TEPA) is relatively limited in scope, as it excludes critical areas like digital trade and e-commerce, offering no preferential measures for these sectors. At the same time, India does not participate in mega trade blocs such as the Regional Comprehensive Economic Partnership (RCEP), while other South Asian countries such as Bangladesh and Sri Lanka, have recently indicated interest in integrating with this East Asian regional trade and GVC hub. As smaller, regional economies are considering trade agreements beyond South Asia, India may want to reevaluate its trade integration strategy, including its options on RCEP. In an ideal situation, more emphasis on plurilateral and multilateral cooperation would be beneficial.

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