

DOMINIK PROCH<sup>1</sup>

## SELECTED MEASURES PROPOSED AND TAKEN BY CURRENT INDIAN GOVERNMENT<sup>2</sup>

*India is going to have the second largest population and one of the largest markets in the world, however, trade and investment environment have been unsatisfactory. The economy was being paralyzed between 2011 and 2013 after long-standing problems had appeared. Nevertheless, a paradigm shift can be seen since 2014. In that year, Indian People's Party won a majority in the general elections and Narendra Modi became the Prime Minister. Under his government, several programs have been introduced and some of them already implemented. The main objective is liberalization, deregulation or computerization, together calling for higher investment and trade exchange. GST is one of the most discussed reforms since it should have brought a unified tax system across all federal states with more transparent requirements for foreign entities. Subsequently, voluminous programs such as Make in India, Digital India, Clean India etc. have being promoted. Despite the fact that businesses can benefit from the outlined initiatives, common people are often affected in a negative way – which is the actual case of demonetisation.*

*Keywords: Indian economy; Narendra Modi; GST; Make in India; demonetization*

*JEL classification: F20, H10, 017*

### 1. INTRODUCTION

This year in August (August 15, 2017), India celebrated its 70th anniversary of independence from the United Kingdom after roughly three and a half centuries of colonial rule. In his festive speech on this occasion, Prime Minister (PM) Narendra Modi called on the people to move forward with a commitment to build “New India” while promoting a reorientation of the country’s future development since his inauguration in 2014. Economic reforms, an upswing of the Indian economy, and changes in the approach to domestic as well as foreign policy must be taken into consideration given the current position of the country in the system of international relations and the world economy. In this respect, India has a great potential to influence global constellation in the coming years. Approximately 1.3 billion people (almost one fifth of the world’s population) represent already the second-largest population which should overtake China to climb to the top position during the second decade of the 21<sup>st</sup> century. According to NIC [2012] estimates, the Indian middle class (in this case membership defined as household expenditures of 10-50 USD per day at purchasing power parity (PPP)) will become dominant contributor to

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the global middle-class consumption by 2030. At the same time, this socio-economic category is considered as one of the main factors of changes in the economy and its members as rational and politically responsible voters. Furthermore, level of middle-class development is seen as one of the aspects of investors' decision-making on potential market entry. A democratic system is also a positive factor of the foreign capital inflow – India, with regard to free elections, its regular repetition, independent press, or existence of a judicial system, declares itself the world's largest democracy. Above all, Indian perspective lays in growth potential that was confirmed at the turn of 2014-2015, when India became the fastest growing large economy in the world by overcoming China.

In spite of the positive list mentioned above and prospective fundamentals that are reflected in economic growth, India has missed (or still lacks) some basic mechanisms that are under given circumstances considered to be the pillars of well-performing governance of advanced market economies. The society is facing a high level of corruption and ubiquitous regulation, lacking adequate infrastructure, facing rampant bureaucracy, but also a vastly uneven distribution of wealth, still existing caste stratification or ethnic-religious tensions. Although Modi named all these difficulties, expressed an intention to reduce them or highlighted progress in their gradual elimination in his speech, the success of overcoming all the shortcomings is not instantaneous.

Still, Modi can rely on a very strong mandate. In May 2014, the Bharatiya Janata Party (Indian People's Party, BJP) claimed a convincing election victory (gaining 282 out of 543 seats, 10 seats more than needed for majority) and the winner of the previous elections – Indian National Congress (INC) – gained only 44 seats. Narendra Modi thus became the leader of the executive branch of the Government of India and headed the BJP's first major government after several decades of coalition governments; moreover, as the first PM born at the time of independence and sovereignty. Guha [2017], in his extensive work, states that for those in the know, this victory was no surprise. At the time when the economy was stagnant, Modi with a positive track record from his position of the Gujarat governor, one of 29 Indian Union states and one of the fastest growing regions of the federation, seemed to be a rational choice to determine the country's further direction.

However, Narendra Modi is not always mentioned in superlatives. The Economist [2012; or 2016] draws attention to connection of his personality with the incidence of the "Gulbarg Society Massacre," during which around 2,000 people, mostly Muslims, lost their lives in 2002 in Gujarat. The violent conflict of religious tensions is attributed to the government of Gujarat, headed by Modi (being the chief minister of the federal government since 2001), since they did not prevent the massacre properly, or even supported anger of the Hindus, according to some theories.<sup>3</sup> The religious question resonates between groups of Modi's supporters and opponents to this day. Criticism is directed primarily towards nationalist, populist and pro-Hindu rhetoric which has contributed to violence in the name of the Hindu sacred creature - the cow. In the press [e.g. The Guardian, 2017; BBC, 2017; etc.], reports have been published over the past three years illustra-

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<sup>3</sup> Based on these allegations, Modi, for example, was refused an entry into the US, which he visited for the first time as one of the selected future leaders in 1990, and where he has been regularly returning [Mahurkar, 2017].

ting murders of Muslims who have become victims of mostly intentional-induced crowd madness. That is caused by indictment of beef handling or just transfer of live animals to slaughter, even though the accusations in the vast majority are not based on the truth. Subsequently, the government is criticized for its unresponsive attitude towards ruffians and criminals who are not brought to justice, even several years after these crimes.<sup>4</sup>

The following article aims to describe and evaluate interventions that the BJP headed by PM Narendra Modi has proposed and has already realized during the first half of its governance. The author follows predominantly economic prism, although the necessary political and social facts are also outlined since they are inseparably linked to the phenomenon.

### 1.1 ECONOMIC SITUATION BEFORE 2014

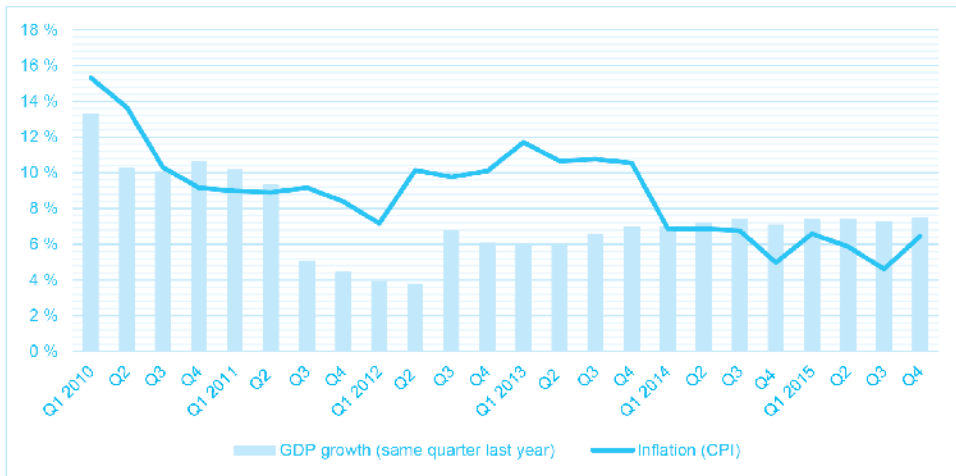
Despite the fact that the British, according to historians [Strnad, 2003; Guha, 2017; and others], applied an approach that allowed Indians to participate partly in governance, developed and improved language skills (ability to speak English) of the inhabitants of the Indian subcontinent and contributed to construction of one of the densest railway networks at that time, the inherited political and economic model began to degrade step by step. In the second half of the 20th century, the economic activity declined and the country was paralyzed by strong regulation, excessive state apparatus, including inefficient state-owned enterprises (SOEs) and the so-called License Raj (or Permit Raj).<sup>5</sup> The country also contended with problems of public finances or high inflation. The solution was in hands of the minister of finance Manmohan Singh. He carried through interventions with an objective of fiscal stabilization, deregulation and liberalization of the economy, followed the (in 1980s) initiated support of science, research, technology and the tertiary sector (especially telecommunications and roots of IT), and came up with privatization of most economic sectors, except those with increased state interest [Joshi, 1996]. This increased state interest can be considered as a manifestation of the state capitalism, i.e. an economic model attributed to India [see Bremmer, 2014; Jiráňková, 2016; and others]. India is usually associated with this economic-political way of state (government) engagement in the economy despite the fact that does not evince signs of authoritative regime and the value of sovereign funds and influential oil and gas companies is far behind the revenues of entities state-owned by typical state-capitalist countries (China, Saudi Arabia, Russia etc.).

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<sup>4</sup> In spite of this tendency, Modi – in his official statements [e.g. NDTV, 2013] – acted with the support of secularism in the spirit of the “India First” approach, i.e. within every activity, the interest of the country as a whole should have a priority. Similarly, he has recently appeared several times supporting Muslim women with their successful movement for the abolition of the so-called triple talaq, also known as the instant divorce, which allowed any Muslim man to divorce his wife by stating “talaq” (divorce) no matter how for three times [NDTV, 2017].

<sup>5</sup> This term illustrates one of tools of socialist central planning which practically froze the whole administrative apparatus. The government, with an aim to control all imports and incoming investments, had introduced a strict bureaucratic and licensing system for almost all operations involving foreign entities’ access into the Indian market. However, as a result of this measure, significant inefficiency of the administrative operations, proliferation of corruption and bribery arose. Only the few who were responsible for granting licenses could benefit from this system and were the most advantageous.

Figure 1 Quarterly inflation and GDP growth between 2010-2015 (%)



Source: IMF, 2016.

Quarter century after the first wave of reforms, before the general elections 2014, political parties were looking for ways offering solutions to almost identical problems. Shortly after recovering from the 2008-2009 crisis, the economy faced unfavorable development again. As can be seen from the IMF's quarterly statistics [2016], there was a slowdown since the second half of 2011 (in other statistical terms – a percentage comparison with the previous quarter – the growth rate even showed negative values) and the GDP growth has oscillated at (comparatively optimistic) 7% already since the year 2014 while using year-on-year comparison. The economic problems also lay in high inflation which had been India facing for a long time, reaching more than 10% in 2012-2013, together with the long-term current account deficit, weak growth in industrial production, sharp decline in investment activity, or more than 10% currency depreciation [OECD, 2014].

Dorschner [2013] considers corruption to be one of the causes of these problems which was also confirmed in the studies of Transparency International [2007-13]. India was ranked 94<sup>th</sup> out of 177 countries surveyed on the basis of perceived corruption index in 2013; while had held the 72<sup>nd</sup> position out of 180 countries in 2007.

The dismal state of public finances and country's foreign-trade position required immediate monetary interventions. In addition to lowering price level growth through inflation targeting,<sup>6</sup> the position of the central bank has been strengthening while seeking gain of an independent

<sup>6</sup> In this respect, the declining oil price is also a major factor in this process since India is the third largest importer and the fourth largest consumer of oil in the world. The same can be said about falling prices of food which accounts for approximately half of the Indian consumer basket. In order to reduce the food prices, subsidies in the form of guaranteed feed-in prices were limited, the market was relaxed and the industrial processing of agricultural production was being supported purposefully.

and trustworthy status in relation to the government. Since 2013, foreign exchange reserves were growing cautiously against a possible tightening of the US Fed monetary policy (by raising interest rates), and thus increase in the volatility of rupee [CNB, 2015].

## **2. SOCIO-ECONOMIC STATE MEASURES AFTER 2014**

The solution of current problems proposed by the BJP (headed by Narendra Modi) proved to be the most attractive option. Given the mandate outlined above, the government could take the first steps shortly after the elections. Analysts [e.g. CNB, 2015] summarize the whole reform effort as liberalization, revival of growth and achieving its long-term sustainability, fiscal consolidation and banking sector reforms, which should be combined together to create a favorable environment for foreign capital inflows. In addition to investments in infrastructure, job creation, supporting new industries, and improving the governance of the country, a number of fundamental changes in the approach to foreign policy is also considered to be a platform to achieve the required level.

### **2.1 MAKE IN INDIA**

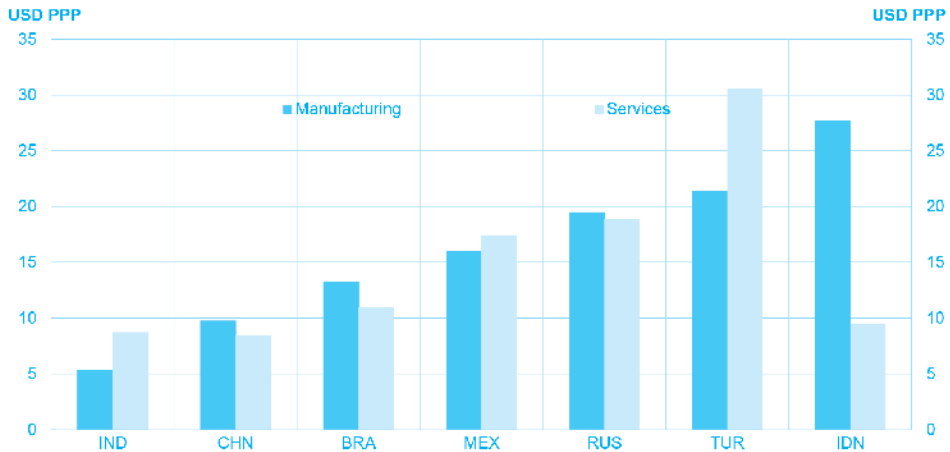
One of the main features of Modi's reforms is opening up to the world through deregulation of the entry of foreign entities, incentives for foreign capital, and efforts to encourage trade exchange. A symbol of this opening up is the initiative of the PM "Make in India". It responds to relatively low development of the secondary sector and aims to attract foreign producers to move and carry out their production on the Indian territory. Foreign capital and technology should contribute to the creation of new job opportunities and upgrading of industrial production [CNB, 2015]. The idea of an economy based on export of manufacturing products is unprecedented in the country which is so far based primarily on services. However, the measures taken are a logical response to the extremely low manufacturing productivity.

If the productivity was measured in terms of gross value added per hour worked in PPP, it would be concluded that India evinces up to twice lower manufacturing productivity compared to China, which has been also struggling with a comparatively low rate of work efficiency in this sector for a long time [OECD, 2014]. The value of this indicator is several times lower than in other BRIC countries as well as countries such as Mexico, Turkey or Indonesia. In tertiary sector, the difference is not so significant (with the exception of Turkey), as confirmed in the above-mentioned figure.

Companies in the manufacturing industry are very small, unproductive and do not offer enough quality job opportunities, which reduces the share of processed products in export and contributes to the scale of gray/shadow economy. In order to reverse this unfavorable development, a whole range of measures has been taken, and dozens of minor as well as larger interventions are planned. In particular, computerization, digitization, introduction of electronic processing in contact with various authorities, extension of the validity period and standardization of official documents, elimination of the need to apply for authorization for selected operations, simplification of payment transactions, or preparation of transparent maps illustrating claims and requirements in individual territories which foreign entities need to meet; these all are the processes, programs and schemes involved in the framework proposed to attract foreign capital and so deal with problems of this sector [MoC, 2016]. The authors have also outlined more than

two dozen specific sub-sectors which are properly supported by the government and in which a business entity in the Indian market finds the most favorable conditions compared to other countries.<sup>7</sup>

Figure 2 Comparison of manufacturing productivity in 2009 (USD in PPP)



Source: OECD, 2014.

Note: The productivity is measured by gross value added at basic prices divided by the number of hours worked and then converted in current USD using the PPP conversion factor for GDP.

As a part of improving the business environment, five industrial and economic corridors should be built between major Indian megalopolises, with an emphasis on planned urbanization and long-term sustainability of industrial as well as residential areas. The importance of infrastructural projects is enormous since they aim to raise a low level of infrastructure that has been one of the weakest and most vulnerable points of the Indian economy to date. These corridors consist from thousands of kilometers of rail and road networks, metro systems in the Ahmedabad and Lucknow metropolitan areas, high-speed train connections between Mumbai and Ahmedabad, as well as dozens of airports, ports and transport hubs. Development of land (ground) transport is becoming more important because water transport in India accounts for only 0.1% of all

<sup>7</sup> For illustration, it is not only about manufacturing industry, but there are also automotive industry and automotive components, aviation and space research, biotechnology, chemical industry, construction, arms industry, electronics and systems, food processing, IT and BPM, leather manufacturing, mining and pharmaceuticals, petrochemical industry, entertainment, tourism, hospitality and spa industry, textiles and carpets, thermal energy and renewable resources, railways, ports and shipping etc. From this point of view, there are representatives of almost all sectors, with some areas, of course, being given more attention. Within each of them, it is briefly stated why India is the right place for implementation of the project in the given sector and basic characteristics, including the relevant policies, regulations and measures necessary to meet the conditions of action are outlined [MoC, 2016].

modes of transport (compared to 20% share of water transport in the case of the US, or even almost 40% of the EU), which is causing enormous use of inland road and rail ways. Via the last mentioned way – railway, up to 3 million tons of goods and 25 million people are transported daily, however, the speed is at most 130 km per hour. The impacts of the construction of high-speed corridors – with a total investment of ca. 6.6 billion USD, supported by 8 billion USD allocated to road and motorway construction – would be dramatic [Klepáček, 2016].

## 2.2 GOODS AND SERVICE TAX

Another pillar of Modi's effort to deregulate and stabilize the market environment is a reform of the tax system aimed at establishing a single Goods and Services Tax (GST). This measure should make the multi-level and fragmented system of central and federal taxes more transparent. Up to know, the mixed system has been confusing and has complicated movement of goods and services among individual states of the union due to its numerous differences and exceptions. Effectiveness should be backed up by the actual creation of an internal market which existence has been so far weakened just by the fragmented tax system. According to Roy [2017], benefits of the free movement of goods and services within the internal market flow not only to foreign entities, but positively affect also the competitiveness of domestic businesses and the economy as a whole thanks to (expected) higher tax revenues, lower collection costs and higher transparency. In addition to unification of central and regional systems, the reform should bring broadening of tax base together with real tax rate decrease, multiplicity elimination, reduction of disputes about the correct taxation of goods as well as procedures simplification and easier automation of tax collection.

The GST despite original plans for implementation in April 2016 remained in competence of the federal states. Just on August 3, 2016, the upper house of the Indian Parliament approved a constitutional amendment that allowed adoption of the above-mentioned measure. Still, approval of the lower house and presidential signature as remaining stages of the lengthy three-part process were missing. First phase was launched even on July 1, 2017 while an unpreparedness of manufacturers and traders played also an important part in this delay [E&Y, 2017]. Even before the implementation, some daunting aspects of the project were visible. More than half of India's GDP lies in services that have so far been taxed at an average rate of 15%. With GST, however, most services are taxed at a rate of 18%. Due to the nature of services, Roy [2017] assumes that rise in their prices may cause higher prices of all goods in the economy, which is the opposite of the original intention. By contrast, petrochemical products that have been associated with inflationary pressures for a long time have remained outside the GST, likewise the electricity or spirits.

Based on the analysis of Sahoo [2016], lack of full centralization will be one of the most problematic future issues. This is related to continuing influence and freedom of federal governments since GST is technically provided by the Goods and Services Tax Council (GSTC) in

which all federal states are represented.<sup>8</sup> So that the GST come into force, it was necessary to obtain a two-thirds majority in at least half of the national assemblies of all federal states and in this respect, there was an obvious concern that the federal governments would not have supported the whole reform at the very beginning without pledge of these control mechanisms. This is a classic example of the sovereignty of individual governments. Worrying about failure of the whole concept, the central government made (additionally to establishment of the GSTC) further concessions, e.g. they have promised to compensate disadvantaged states for income tax losses for a period of five years.

The GST is not the only tax measure. Another change related to the tax system is represented by a principle of taxation on the basis of value added instead of turnover, with exports being fully exempt from taxation and imports being subject to the same tax rate as domestic goods and services according to the final place of consumption.

### 2.3 DIGITAL INDIA

The “Digital India” program has been already partly introduced by the reference to computerization, digitization and introduction of electronic processing in bureaucratic operations. Nevertheless, many more plans and functionalities are included. The vast majority of “digital” measures are crucial in terms of distances and related complications that are still associated with visits to authorities and officials. Proposed changes aim at the state administration itself which should be transformed to the form of e-governance while increasing the efficiency and transparency as well as accelerating decision-making, bureaucratic and managing processes at all levels, including sufficient capacity of cloud centers etc. The program also offers significant investments in telecommunication and Internet networks construction as well as power lines to places without connection. Furthermore, number of multipurpose contact centers (including electronic access to banking, education or health services and certifications) together with redesigned post offices of similar use are being established [MoEIT, 2017].

Mahurkar [2017] remarks that greater transparency and accountability of governmental representatives achieved through introduction of new technologies – and thus elimination of intermediaries – have increased the effectiveness of subsidies and other resources, contributing to an annual saving of ca. 1 trillion INR (about 15.6 billion USD). One of the first Modi programs, “Pradhan Mantri Jan Dhan Yojana” (Prime Minister’s People Money Scheme) launched in August 2014 is seen as a prerequisite for this success. Based on developed technology platform, it aimed at financial inclusion through providing access to financial and banking services with interface tailored to the needs and knowledge of the poorest. The official data [MoF, 2017] have showed success of this campaign. More than 300 million bank accounts have been set up so far. Private bank accounts facilitate transfer of funds directly to designated entities without any need to use intermediaries who contributed often to considerable losses.

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<sup>8</sup> Besides others, the GSTC decides about specific tax rates, income allocation, inclusion of specific goods or services in individual tax groups etc. Roy [2017] describes four established categories of taxation, namely 5% for selected products (tea, coffee, spices, etc.), 12% for goods of basic needs, 18% for most of goods in the economy and 28% for inessential goods, i.e. tobacco products, but also cars etc.



Although India has been considered as the global IT center over a long period, the nature of Indian IT industry lays primarily in outsourcing and lower value added services. One of the goals of the Digital India program is to move up the global value chain in the IT sector and decentralize IT centers to smaller cities and new areas in the northeastern region (thus disintegrate the existing concentration in the Bangalore metropolis) where training and educational courses for potential workers have been taking place [MoEIT, 2017].

## 2.4 CLEAN INDIA

The “Clean India” Initiative (more often also “Swachh Bharat” in Hindi) may seem unrelated to improving conditions for trade, industry and investment at the first sight. But the opposite is true. India is currently one of the most contaminated and polluted parts of the world. In this regard, insufficient hygiene standards can be naturally a deterrent factor for relocation of more demanding production onto the Indian market. Supported by influential and well-known personalities, Modi has fought for improvement of living standards and quality of life through environmental protection, cleaning the sacred Ganga River (see the so-called Clean Ganga program; the importance of this river is still evident since almost 40% of the population lives in its basin), increasing people’s health condition and sufficient availability of toilets, disseminating awareness or establishing waste management facilities. Complementary, programs such as available housing supply, rural development, aquatic ecosystems, or electrification expansion have been introduced. Some others are focused on increase in drinking water supply. At the same time, its dearth is one of the most pressing problems of contemporary India [Vishwakarma, 2016].

An effort to achieve a higher living standard, sustainable urbanization and availability of quality housing is incorporated also in the Smart Cities program. An ambitious goal of the program is to promote 100 selected medium-sized towns and cities to sustainable, modern and comfortable satellites of vast megalopolises. The mission is supported by an array of tools to build an internal ecosystem of the city by integrating institutional, physical, social and economic infrastructure. Specific tools consist of so called Smart Solutions that are once again based on digitization, electronic procedures or IT interconnection of urban systems. They enable energy savings, use of renewable resources and deeper recycling, introduction of more efficient waste management, increase in efficiency of security services and use of water resources as well as smart management of public transport or affordable housing. From raising living standards of the population, authors of this idea expect to involve poorer classes in everyday life and thus achieve better economic growth [MoUD, 2016].

## 3. EVALUATION OF STATE INTERVENTIONS

The aforementioned list of reforms is in compliance with coherent and coordinated reform approach of the Indian government embodied in the framework set out in the 12th Five Year Plan for 2012-2017 with the subtitle “Faster, More Inclusive and Sustainable Growth”. In this document, there are set the same goals that the government has strived to achieve by partial reforms, i.e. liberalization of the economy, ensuring macroeconomic balance, supporting agricultural and industrial production, and thus reducing social and economic inequalities through the parallel creation of new job opportunities. However, attention is also paid to investments in

infrastructure, more balanced planning of the urbanization processes, or ensuring energy security and environmental protection [PC, 2013].

Modi's policy (also known as "Modinomics") undoubtedly aims at making India's market more accessible, liberalized and modernized. However, effects of this effort have much wider range. By eliminating inefficiencies, the above-mentioned bureaucratic burdens, corruption and laziness, India is able to succeed even against other issues. Beside others, governmental measures have resulted in suppression of rebellious (guerrilla) tribes which had a negative effect on market environment in the northern part of the territory. As a positive externality, some economists and financial experts [e.g. Milon, 2016] consider planned increase in wages of governmental officials which can be reflected in the middle class growth and its increased consumption (especially in cities and suburban agglomerations) with implications for further boost of economic activity.

On the other hand, it is needed to emphasize that governmental interventions are not perceived only in a positive way. First of all, Modi is criticized for insufficient privatization of inefficient SOEs, slow implementation of the planned reforms, their uncertain consequences, and often also for incorrect means of accelerating reform outcomes. The PM comes under criticism on the grounds of considerable self-promotion, which is inconsistent with the speed of concrete steps and reforms' implementation. As an example may serve an attempt to re-establish relations with former partners and the most influential economies of the world. Manifestation of a comprehensive change not only in domestic but also in foreign policy is reflected in clear intensification of participation in international organizations at all levels of cooperation or official visits to formerly neglected partners (Pakistan, Nepal, Australia, Japan, China, Germany, France, Arab or African countries and others) and increase in bilateral cooperation after several years of weakening. Till the beginning of 2017, Modi had made more than 50 international trips for this purpose [Modi, 2017b] which was more than number of trips abroad made by US President Barack Obama for the same period and which resulted in two-year incessant travelling. Besides a number of populist and nationalist expressions, it is just a frequent absence on the domestic scene which is the target of criticism and which certainly limits the possibilities of more effective implementation of the proposed changes. Permanent persuasion of reforms' positives has been somewhat hindering their full development. Delayed GST introduction may be a clear example.

Another example may be the effort to build Smart Cities, concept of state-of-the-art city construction with green technologies, renewable resources and automatic systems improving daily lives of its inhabitants. On the other hand, concrete Smart Cities projects have been already accompanied by gradual destruction of slums and violent removal of illegal houses occupied by people living in the slums. As a consequence, there were millions of homeless people who were not adequately cared for and came into an even more precarious and difficult situation. Therefore, it is important to understand the issues and changes complexly, and not just follow their targets that are often framed in superlatives.

### **3.1 DEMONETIZATION**

The current government role in promoting the move towards more liberal, transparent and market economy, and possible deviation of public perception of government intervention is confirmed by the demonetization announced by PM Modi on November 8, 2016 during an unscheduled live broadcast. On that day, 500 and 1000 rupee banknotes – in total value of 15.44 trillion INR (241 billion USD; about 86% of the money supply) – were demonetized. The next day, all

banks and ATMs were closed, and new banknotes were gradually released for the exchange under the strict supervision of financial authorities with a daily exchange limit.<sup>9</sup> Originally, the central bank announced deadline for depositing invalid banknotes in bank accounts until November 30 the same year. Nevertheless, all exchange was suddenly stopped from November 25, 2016. According to governmental estimates, the total volume of currency in circulation should have been reduced by 30% [Financial Times, 2017]. The main aim of this action was to prevent funding illegal activity and terrorism from counterfeit banknotes, and notably from the previously undeclared funds from illegal, illicit or non-taxed activity. It was concluded that a significant part of these funds would not have been exchanged due to a concern of disclosure, increased supervision by the financial and tax authorities, or even prosecuting authorities. In this respect, gray economy has been so far holding a significant position, making implementation of many measures more difficult, particularly in the tax field. Based on the study of ILO [2017], steadily 80-90% of people work in informal sector which contributes to the fact that India is a country with one of the highest use of cash transactions. As illustrated in Bloomberg [2016] report, the volume share of transactions carried out in cash is ca. 98% while the gray economy represents approximately one fourth of the Indian GDP. An effort to suppress this phenomenon has proved to be counterproductive. Demonetization and related consequences have affected hundreds of millions of people in their everyday life. Most of them live in remote areas with complicated access to banknote exchange centers. Exchange, or verification of their life savings respectively brought additional uncompensated costs [Reuters, 2016]. The controversy of the action is particularly enhanced by the Report of the Reserve Bank of India [RBI, 2017] which identified that by June 30, 2017, 99% of the total money supply allocated in 500 and 1,000 rupee banknotes (15.28 from a total of 15.44 billion rupees) were exchanged or deposited in banks. At the same time, only a slightly higher amount of counterfeit banknotes was detected compared to the previous year. The main objectives of the entire operation have thus been in vain, while the short-term monetary constraints hit up to 250,000 business units, farmers, real estate sector, have caused so far unquantified additional costs and considerable wave of indignation [BBC, 2017]. Causes of this unease can be found in the structure of the Indian retail market and consumer habits. In 2016, according to IBEF [2017], the so-called organized retail was just 9% (about 60 billion USD) of the overall retail market. Concurrently, the retail sector accounts for more than 10% of Indian GDP and about 8% of total employment. Unorganized retail (family type, with negligible floor space and less than 10 employees) represents remaining 91% of the country's retail sector and is absolutely dependent on cash transactions – as already mentioned above.

There are several possible reasons why demonetization have not reached its goal. Besides inaccurate government estimates caused partly by difficulties of statistical collection and analysis of Indian economy's fundamentals (similarly to other developing countries), it was par-

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<sup>9</sup> In the first phase (from 8 to 13 November), the limit for exchange over the counter was set to 4,000 INR per person per day. In the second phase (from 14 to 17 November), the daily limit was raised to 4,500 INR and in the third phase (from 18 November) reduced again to 2,000 INR. At the same time, exchange for foreigners and out-bound travelers enabled at international airports was limited to 5,000 per person per day. ATM withdrawals were restricted to 10,000 INR per day, or 20,000 INR per week respectively from 10 to 13 November with an increase to 24,000 INR from 14 November.

ticularly rapid response and quick solution which the affected people came up with. The practice has shown that exchange of “black and dirty money” was realized with a remunerated use of intermediaries, i.e. people who did not need to exchange cash for themselves through bank accounts. The effect of the monetary measure was completely neutralized by the establishment of an organized network, consisting of owners of illicit cash, “brokers” and poor and indigent people. Those standing at the top of this provisional pyramid were using intermediaries (against payment in the form of exchange for lower than nominal value of banknotes) who further distributed the banknotes to the countless number of people with lowest income. They subsequently took them to official places for conversion into a new currency or deposited them as a credit in bank accounts. Moreover, other ways to overcome the regulatory intervention were found – such as donations, extra pay for employees etc. [Financial Times, 2017].

The official government diction, however, highlights achievements of the demonetization. The PM website [Modi, 2017a] pointed out cleaning and formalization of the financial sector with ca. 2 million suspected bank accounts, effectiveness of the fight against terrorism and communist extremists in the northeast of the country, strengthening of tax compliance with over 26% increase in the number of new taxpayers or almost 60% increase in digital payments with even more significant success in the field of debit card transactions (easier to control) – increase of 93% in the value of transactions and approximately 103% according to the number of transactions. However, the highest increase has been detected in mobile phones payments through IMPS software (Immediate Payment Service), namely 142% from the value perspective or 123% as for the quantity increase. In this respect, transactions through the so-called mobile wallet increased by 136% (value), respectively 218% (quantity). In addition, the government considers real discounting of loans with a fall in interest rates of around 100 basis points, together with a fall in property prices or a threefold increase in municipal and district revenues to have purely positive impact too.

#### **4. CONCLUSION**

The aim of this paper was to introduce and evaluate (mainly economic) changes, programs and plans that have been taking place in India since 2014. Since that year, Narendra Modi has been the Prime Minister while leading the majority government formed by the Indian People’s Party, an unequivocal winner of the 2014 general elections. There is no doubt that Modi is an experienced politician and long-term governor of Gujarat which he had brought to one of the best performing federal states of the union. Shortly after introduction to the office, Modi launched a series of dynamic programs and plans aimed primarily at liberalization, deregulation, increased transparency and high but at the same time sustainable economic growth achieved mainly through market reforms and attracting foreign capital.

The direction which the Indian government has started out can be seen as a basis for multilaterally successful cooperation, whereby foreign businesses can benefit from still relatively cheap and large-scale workforce, government incentives, infrastructure development, and a stabilizing market environment. The Indian side can benefit from companies’ spending and investments, or from contact with imported technologies and know-how similarly as China since the 1980s. Growth increase and sustainability depends, in particular, on the actual improvement of business conditions which are the main impetus for the arrival of strong partners (whether at the level of countries or individual companies). Later on and with increasing economic power, it is

also possible to expect strengthening of political or military-strategic role in the system of international relations and world economy.

Nevertheless, obstacles have been hitherto eliminated slowly, reforms have been gradual, and some seem to be somewhat counterproductive in the midterm of this process. Some of the introduced reforms – e.g. the actual demonetization and steps aimed at suppressing the gray economy or creating a single internal market – are perceived negatively since they have been restricting ordinary people in their everyday life. Despite these imperfections and ongoing criticism of the mentioned issues, it is possible to see initial results of the taken measures. First signs of reduction of bureaucratic burdens and elimination of redundant components of the bureaucratic apparatus have been emerging. For example, the number of ministries has been so far cut by a quarter. As for the enhancement of trade and investment flows, India achieved a FDI inflow of 123 billion USD between 2014 and 2016 which is roughly 50% increase compared to the three-year period 2011-2013 [UNCTAD, 2017].

Final impact of the implemented measures could be assessed only in the long term, with a decisive moment in 2019. That year, voters will have a chance to express their attitude and dis/agreement with the economic direction set by Narendra Modi. In the next elections, they will weigh up if the promises have been only empty and populist phrases with no (or negative) impact on the population, or if the economic measures bring the country to the “New India” era.

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