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BEHIND INDIA'S ECONOMIC SLOWDOWN, OUR VERY OWN DEEP STATE

The Need for Overhauling the Policymaking Framework

- The Indian annual budget process, rooted in colonial-era traditions, continues to operate with limited transparency. This 200-year-old practice is conducted behind closed doors, isolating it from democratic scrutiny.
- Designed for an era of centralized power, the process now caters more to bureaucratic interests and media narratives than to the needs of a modern democracy.
- A reform in the budgetary framework is essential to ensure participatory decision-making that aligns with India's developmental priorities and economic realities.

Economic Slowdown in the Face of Global Expansion

- India's economic slowdown stands in stark contrast to global economic growth, with the IMF projecting optimistic figures for global GDP expansion.
- Historical analysis reveals that policy missteps, such as maintaining high real interest rates, contributed to the pre-COVID economic deceleration of 2018-19.
- Beyond monetary policies, the slowdown is exacerbated by factors like high personal income tax rates, excessive tariffs on manufactured goods, and restrictive foreign direct investment (FDI) norms.
- These protectionist measures reflect a resistance to global trade dynamics and hamper the competitiveness of Indian industries, stalling economic progress.

The "Deep State" and its Grip on Policy Formation

- Policymaking in India is often influenced by a nexus of industrialists, senior bureaucrats, and media influencers—referred to as the "Deep State."
- Unlike mature democracies where independent experts play a significant role, India's policy decisions frequently exclude lateral entrants and external advisers.
- Historical precedents, such as former Prime Minister Manmohan Singh's successful inclusion of external expertise as Finance Minister, highlight the benefits of independent advice. However, these practices have waned over time.

- The Modi administration, despite initial promises of reforms, has struggled to break free from the entrenched influence of this "Deep State," delaying transformative policy shifts.

Fiscal Deficit Fixation: A Narrow Economic Approach

- India's fiscal strategy prioritizes reducing the fiscal deficit, often at the cost of broader economic goals like growth and development.
- This is achieved through increased taxation rather than fostering economic activity, a method that has limited impact on controlling food inflation.
- Critics argue that this approach lacks a growth-oriented perspective, undermining long-term economic sustainability and neglecting key sectors like infrastructure and manufacturing.

Personal Income Taxation: A Misaligned Policy

- India's personal income tax-to-GDP ratio (X-PIT) is projected to reach 3.9% by FY2025, significantly higher than most non-advanced economies.
- Comparisons with China (1.1%), Vietnam (1.8%), and Brazil (3%) reveal India's disproportionately high tax burden, which is out of sync with its developmental stage and income levels.
- Developed countries like Korea (4.8%) maintain similar X-PIT ratios but with far higher per capita incomes, underscoring the misalignment of India's tax policies.

Total Taxation: Overburdening a Developing Economy

- India's overall tax-to-GDP ratio (X-TAX) is expected to exceed 19% in FY2025, on par with developed nations like the USA (19%) and Korea (20%).
- This high taxation is disproportionate to India's economic capacity, given its much lower per capita income compared to these nations.
- In contrast, developing economies like China (15.9%) and Vietnam (14.7%) maintain lower tax ratios, fostering greater economic activity and investment.

The Economic Costs of Excessive Taxation

- High taxation levels lead to increased government spending on populist measures, often referred to as "freebies," as criticized by Prime Minister Modi.
- The middle class bears the brunt of these taxes, fueling dissatisfaction that contributed to the BJP's declining popularity in recent national elections.
- Excessive taxes, coupled with restrictive FDI policies and high real interest rates, deter investment, innovation, and entrepreneurship, stifling India's economic potential.

International Influences and Policy Misalignments

- Global institutions like the IMF and World Bank have influenced India's tax policies, particularly in areas like GST reform.
- While these recommendations aim to enhance revenue collection, they often fail to consider India's unique economic realities, leading to suboptimal outcomes.
- Despite decades of discussion on direct tax reforms, successive governments have failed to implement meaningful changes, perpetuating systemic inefficiencies.

Conclusion: A Call for Comprehensive Reform

- India's fiscal policy is at a critical juncture, burdened by excessive taxation, protectionist measures, and the exclusion of independent expertise in policymaking.
- These structural issues hinder economic growth, reduce competitiveness, and alienate key stakeholders like the middle class and global investors.
- Immediate reforms are essential to realign fiscal and economic policies with developmental goals.
- Prioritizing growth-oriented strategies, fostering inclusive policymaking, and embracing global best practices will be crucial for unlocking India's economic potential.
- Addressing these challenges by the next budget cycle is imperative to ensure sustainable development and equitable growth for all.

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