Governments across the world have been reorienting their policies in the last two years, as the pandemic transformed economies and geo-political situation. The overarching focus is now on reviving and sustaining growth, even as policymakers and businesses are dealing with the emerging challenges like new COVID variants, supply chain disruptions and rising input costs. In the current reset, what should be India’s policy priorities to fuel growth and drive investments and jobs?

The above information sets the backdrop of the Special Edition on “India’s Growth Rebound: From Ambition to Action”, which captures insightful discussions and recommendations from EY India’s Policy Roundtable on the theme, held in December 2021.

The discussions on significance of ESG (environmental, social, and governance) have moved from backrooms to boardrooms. Increasingly, stakeholders in companies are evaluating a business’ ESG performance before investing. How companies address sustainability and social issues, and how they maintain tax transparency and reporting have become more central to their business strategy. The Session on ESG discussed how the focus on environmental, social, and governance aspects can help businesses improve long-term value. It also explored the global practices on decarbonization and carbon pricing and the challenges and opportunities in the Indian context.
India continues to use various trade policies and tariff instruments to support domestic production and exports. The session on aligning trade policy with vision 'Atmanirbhar Bharat' focused on policy measures related to the upcoming FTP, strategies to boost domestic manufacturing and exports. The compatibility of Atmanirbhar Bharat with globalization, and challenges faced by businesses under the current trade policy were some of the critical issues discussed at the roundtable. The experts also deliberated on how India can handle the conflicting objectives in the FTP at the generic level.

The international tax landscape is undergoing a significant change and multinational companies are likely to face a dynamic tax environment in the coming years. The session on BEPS 2.0: Future of International Tax and what it means for businesses brought out different tax aspects of the ongoing global tax reforms led by the OECD and how companies are dealing with the tax policy changes concerning Pillar 1 and Pillar 2. The panelists also deliberated on the future of international taxation and if the new framework may restrict or broaden the Indian Government’s ability to offer targeted income tax incentives.

Finally, the session on Unleashing India’s economic potential: risks and opportunities deliberated over India’s economic outlook, strategies to deal with emerging challenges such as the new OMICRON variant, supply chain disruptions, climate concerns and rising input costs that could dampen the country’s growth. The experts also shared growth trends and discussed policy measures needed to uplift growth in the mid-to-long term.

We hope this publication helps you understand the key policy drivers affecting businesses in India. We look forward to your feedback and suggestions.

Sushrut Kapadia
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Transparency: a business imperative in a world of Environmental, Social and Governance (ESG)-led investing

Uniform global reporting metrics help in obtaining quality ESG disclosures.
ESG – environmental, social, and governance – is a hot topic in boardrooms today and is impacting business decisions. There is a verifiable surge in investor and stakeholder interest (including policy makers and NGOs) in companies that take ESG seriously. Investors are also increasingly considering business’ ESG performance in their financial decision-making. While investors have made their demands for ‘investment grade’ information clear, it is difficult for businesses to determine what, how and how much to report.

Against this backdrop and to understand how ESG can help businesses improve long-term value, EY on 8 Dec 2021, brought together global business leaders in a virtual roundtable. Moderated by Chaitanya Kalia, Partner and Leader, Climate Change and Sustainability Services (CCaSS), Mukund Govind Rajan, Chairman, ECube Investment Advisors; R Mukundan, CEO, Tata Chemicals; Reto Isenegger, EMEIA Sustainability Markets Leader & Sustainability Strategy and Transactions Leader, EY; and Rajnish Gupta, Associate Partner, Tax and Economic Policy Group, EY participated in the round table.

The panel commenced the discussion with the increasing popularity of ESG investing and how investors prefer companies that achieve ESG goals. Against the backdrop of PM Modi’s speech at the COP26 concluded in Nov 2021, the panel discussed the effectiveness and challenges of the carbon pricing strategy in achieving the country’s net-zero goals. ESG, especially climate policies should not be seen as a cost or a part of being responsible corporate but as an incentive to innovate. The idea of ESG being something noble to do may be obsolete. The question is who moves in first with innovation.

Deliberating on the issue of data transparency and ESG reporting, the panelists insisted on the need for uniform global reporting metrics and how globally-accepted ESG standards will improve the quality of disclosures and make life easier for companies, investors and policymakers alike.

Setting the context in which investors evaluate companies and the impact of ESG on decision-making, the panel asserted that it is essential to determine whether a company’s top management understands the gravity of the issues around them. The concept of materiality is critical here. While a company is not expected to perform outstandingly across different attributes, those that are particularly material for its industry are critical.

The recent 2021 EY Global Institutional Investor Survey echoed similar sentiments. According to the survey, 74% of investors worldwide are more likely to divest from companies with poor ESG track records.
Carbon pricing: challenges and opportunities for India

Prime Minister Narendra Modi announced, at the recently concluded COP26, that India’s carbon emissions would come down by a billion tonnes by 2030.

"Carbon pricing is the most cost-effective and flexible way to achieve emission reduction.

The biggest advantage of the carbon tax is that it is easy to implement because you can put it as part of GST. However, carbon taxes are not politically palatable. Nobody likes taxes, so to be able to get this strategy across the line is very difficult.

Rajnish Gupta

1. COP26 summit | India will achieve net zero emissions by 2070, says PM Modi - The Hindu
As far as emissions trading in India is concerned, the government may first have to set targets for particular industries. This will help add some subjectivity. Next, policymakers may need to create mechanisms to measure emissions, set institutional authority, and freeze the permissible limit for emissions. A clear regulatory framework for carbon pricing in India can help increase businesses’ uptake of carbon pricing. However, while improving enforcement across sectors is vital, the real challenge is to explore the potential for linking with the global carbon markets.

Disclosure is not transparency

Discussing an investors’ perspective and deliberating on the issue of transparency, one of the panelists shared that almost 75% of the disclosures looked at by the Sustainability Accounting Standards Board (SASB) are not material. Also, 90% of the adverse events do not get disclosed. This speaks a lot about the lack of transparency in ESG disclosures.

The reality is that the demand for transparency over ESG activities is set to increase. Businesses that do not share relevant information or publish inaccurate data will miss out on access to capital. Those able to hit the right notes with investors and stakeholders will gain an edge.

Looking at the ESG risks and opportunities from investors’ perspectives, the panel agreed that there would always be concerns around the trade-off between risk and reward. Investors need to consider the time frame in which they want to see the delta in their performance and whether their competition is doing it simultaneously.

Need for global policies and regulations to make decarbonization happen

In the past, businesses might have responded to stakeholders’ demands with well-chosen words and glossy pictures in the annual report. But today, such tactics are neither adequate to manage ESG as a public relations issue nor enough to handle the demands of investors. What investors want is convincing evidence of a sustainable economic model. This requires the disclosure of a set of nonfinancial metrics. The question now is: which ones? And this is where the concept of materiality comes in.

Panelists echoed the sentiment that companies can publish as much data they want on which they are doing well. But if those items are not critical to their core business, it is elusive.
Atmanirbhar Bharat: vision requires aligned, not isolated, trade policies

The Government has to identify policy and other improvements for Indian exporters.
Atmanirbhar Bharat – the Indian Government’s vision to improve local production of goods has attracted both criticism and praise. While experts continue to be divided on the impact of Atmanirbhar Bharat on trade and in its role in positioning India as a manufacturing hub, attaining the stiff export target of US$1 trillion by FY26 requires a multi-dimensional foreign trade policy (FTP).

To examine the challenges at the policy and operational levels and offer suggestions for improving the forthcoming FTP, EY brought together global business leaders and policy makers in a virtual roundtable. Moderated by Uday Pimprikar, National Indirect Tax Leader, EY, participants in the roundtable included Rajesh Aggarwal, Chief of Trade Facilitation and Policy for Business at International Trade Centre, Geneva; Jayant Dasgupta, Former Ambassador to WTO; Manoj Pant, Vice Chancellor, Indian Institute of Foreign Trade (IIFT); and Agneshwar Sen, Associate Partner, Tax and Economic Policy Group, EY.

Policy measures related to the upcoming FTP, strategies to boost domestic manufacturing and exports, the compatibility of Atmanirbhar Bharat with globalization, and the challenges faced by businesses under the current trade policy were some of the critical issues discussed at the roundtable. The experts also deliberated on how India can handle the conflicting objectives in the FTP at the generic level.

2. Stiff target: New Foreign Trade Policy aims for exports of $1 trillion by FY26 - The Financial Express
One of the panelists was of the view that India might not be able to sustain the US$400 billion mark in the mid-to-long term as the pent-up international demand will get fulfilled sooner or later. To sustain this growth, we will need to diversify our export basket and its direction.

Another panelist noted that Indian exporters do not engage much in high-tech exports.

In 2021, India's export performance was at a record high. The April-October exports in FY20-21 are almost 26% higher than the same period in FY19-20 and the highest in a decade. With this robust growth in exports, India seems to be on track to hit the US$400 billion mark this year. However, is this growth sustainable?

Also, a renewed focus with targeted support on services export would trigger the export numbers and help make this growth sustainable.

The Indian Government has taken several initiatives over the years to boost exports. One of the key initiatives, the ‘Production-linked Incentive’ (PLI) scheme, which supports manufacturing in a variety of sectors by providing incentives for production. Under the PLI scheme, an outlay of US$26.47 billion\(^3\) has been allocated to boost manufacturing and thereby exports.

However, Indian manufacturers and exporters are expecting the new foreign trade policy (likely to be announced in April 2022) to provide a favorable environment and address the shortcomings of the current FTP 2015-21 in terms of procedural simplification.

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3. 42 Companies Selected Under PLI Scheme For White Goods: Centre | IBEF
Atmanirbhar Bharat: vision requires aligned, not isolated, trade policies

India signed 11 Free Trade Agreements (FTAs) between 2004 and 2011, but none since. As per the Department of Revenue, Ministry of Finance, India’s trade balance is unfavorable with most of its FTA partners. India’s trade deficit with ASEAN, Japan and South Korea has increased after concluding the FTAs. The revenue foregone more than doubled in 2018-19 due to customs duties waived as part of the ASEAN-India FTA.

However, backed by the current growth in exports, a confident India is again looking to forge bilateral trade agreements with major export destinations such as the EU, the UK, and the US. This seems like a complete turnaround from 2019 when India had walked out of the Regional Comprehensive Economic Partnership (RCEP), the mega-regional trade agreement of East Asia, citing “unresolved concerns” with China.

India has fast-tracked trade deals with half a dozen countries, including UAE, UK, EU, Canada, and Australia, in line with its revamped FTA strategy. These trade deals assume more significance now as India is not a part of any significant regional trade bloc. In terms of architecture, we are looking at a much more evolved negotiating approach from India because we need these FTAs to participate in the global value and manufacturing chains. On the timeline front, I feel the FTAs with UAE and Australia are likely to get finalized by the first quarter of 2022.

Agneshwar Sen

During the roundtable, experts echoed the sentiment that India’s approach toward forging new FTAs and expanding the existing ones is on the right track. However, there is an immediate need to rebalance the country’s trade strategies. The new Foreign Trade Policy 2021 must provide policy guidance and a direction for future trade agreements. The benefits of FTAs must be strongly communicated to the industry and they must be taken on-board for future trade deals.

Lack of information on FTAs, complex rules of origin, higher compliance costs, and procedural delays discourage exporters from using preferential routes. Eliminating these hurdles and ensuring that FTAs focus on ease of doing business will go a long way in making Indian manufacturers globally competitive, attract foreign investment in core competency areas, and make India an integral part of the global supply chains.

Is RoDTEP the silver bullet to eliminate challenges faced by the Indian exporters?

The Indian Government has lent a helping hand to exporters through a new export promotion scheme - Remission of Duties and Taxes on Exported Products (RoDTEP).
RoDTEP is an important mechanism that has been put in place to make Indian industry efficient. While it is not an incentive to the industry, it is just rebating the taxes, which is right, as taxes and levies on exports should either be exempted or remitted. Due to budgetary constraints, RoDTEP has only taken off for the goods sector for now. I am confident that we will be looking at a much more expanded RoDTEP by the next budget, that could include services exports as well.

Agneshwar Sen

Commenting on India’s strategy, the experts insisted that India must engage in all global forums. Holding back or standing out will not help us create the global rules and systems required for seamless adoption of new and evolving technologies. The experts were of the view that for India to be a global leader, it will have to significantly invest in research and development. Panelists also suggested that the new FTP should cover support for upgrading technology and upskilling Indian workers —this will eventually help the exporters be competitive rather than rely on government subsidies.

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BEPS 2.0: Future of international tax and what it means for business

Rasmi Ranjan Das
Joint Secretary, FTTR - 1,
Government of India

K Balasubramanian
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Chris Sanger
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Vijay Iyer
EY India Transfer Pricing leader

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BEPS 2.0: Future of international tax and what it means for business

On 1 July 2021, of the 141 members of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (also known as BEPS 2.0 project), 137 signed onto the statement that set forth the key terms for a two-pillar framework to overhaul the international tax rules.

With such significant changes in the international tax landscape, multinational companies are likely to face a challenging operating environment in the coming years. Since India is a significant market jurisdiction, it benefits from the additional taxing rights under Pillar One of the BEPS 2.0 model.

But how does an India outbound business look at BEPS 2.0, and what are the expected implications on businesses? Looking for answers to such questions, EY hosted a curated roundtable moderated by Vijay Iyer, National Transfer Pricing Leader, EY, joined by Rasmi Ranjan Das, Joint Secretary, FTTR – 1, Government of India; Chris Sanger, EY Global Government, Risk Tax Leader, EY EMEIA and UK&I (Tax Centre) Tax Policy Leader; and K Balasubramanian, Vice President and Global Head – Corporate Taxation, Wipro. The panelists discussed the global tax reforms led by the OECD and how companies are dealing with the tax policy changes concerning Pillar 1 and Pillar 2. The panelists also deliberated on the future of international taxation and if the new framework may restrict or broaden the Indian Government’s ability to offer targeted income tax incentives.
BEPS 2.0 India perspective: a right step in the right direction

Under the existing law, different countries can impose different corporate tax rates on multinational companies. As a result, MNCs tend to locate lower tax jurisdictions (to minimize their tax burdens) and treat more (or all) of their profits as “sourced” to that country, bringing down their effective tax rate. This leads to increased tax revenues in countries with lower tax rates and decreased revenues in countries with higher rates. These tax strategies are called a “profit shifting” and result in “base erosion” in countries with higher corporate tax rates. India alone loses millions and billions of dollars in taxes annually owing to “global tax abuse” by MNCs. This led the international tax community to turn its attention to the problem of corporate tax avoidance. The other problem which faced the Governments was the fact that large MNEs were able to earn revenue in foreign markets with having a physical presence there. Under the current international tax rules, these foreign markets could not seek a claim on the tax revenue arising from the local engagement of foreign MNEs. In response, several countries (including many G20 countries) have imposed “digital services taxes” on the revenue (rather than profit) of major technology firms to recapture some of the lost tax revenue. However, both countries and MNCs see this system as inefficient. BEPS 2.0 OECD aims to solve this problem.

The key part of the BEPS 2.0 is to address tax challenges resulting from the digitalization of the economy. While Pillar One aims to reallocate market jurisdictions of taxing rights that require a physical presence of a multinational in the market country, Pillar Two aims to set a global minimum tax rate of 15%. Overall, the two Pillars of BEPS are a commendable step forward in the global fight against tax gaps and large-scale tax evasion based on a historic global consensus from 136 countries.

India is primarily a capital importing country. Commenting on the outcome of BEPS 2.0 from an Indian perspective, panelists agreed that it is a significant step towards having a more stable and fairer international tax system. Another panelist added that the outcome of BEPS 2.0 is expected to be good for most nations. One of the panelists described Pillar One of the BEPS 2.0 model as “the fundamental reallocation of taxing rights after the 1920s.” The panelist added that India has participated “very actively in BEPS 1.0 and 2.0” as the country has realized that century-old tax reforms are no longer fit for the 21st-century economy.

For instance, the biggest concern of Indian MNCs doing business overseas is that their income should be taxed only once. For most large enterprises, the ETR is around 11%, but an average Indian MNC’s ETR is upwards of 25%. These Indian MNCs will not be worried about Pillar One, as the threshold is much higher. They will be worried about the reallocation. So, if there is a broader agreement on BEPS minimum standard of 15% where most countries could come together, Indian MNCs might have a sigh of relief in terms of compliance hurdles as they would not have to talk to multiple tax authorities in different countries. The Indian MNC would benefit immensely from Pillar Two. However, companies doing business with India that are at risk of equalization levy will have to relook their structure regarding how they will comply with Pillar One.

Explaining how the narrative in the international taxing landscape has changed in the last decade, one of the panelists added that the fundamental purpose of the Double Tax Avoidance Agreement (DTAA) was to prevent payers from paying double taxes on the same income. Then comes BEPS 2.0, which will treat the entire MNC group as one entity and ensure a minimum level of taxation. The disadvantage of not having any such solution will be multiple unilateral measures and trade tensions that would inhibit investment in growth.
Implementing the new global tax rules will give rise to a different attribution of tax revenue. According to an estimate by the OECD, Pillar One could see over US$100 billion reallocated to the market jurisdictions, while Pillar Two may help generate more than US$150 billion in new tax revenues globally.

As a result of increased tax certainty, the two-pillar package will lead to a better global environment for growth and investment, bringing benefits to tax administrators and payers.

Giving an overview of what is happening around the globe and how countries and companies are responding to the new tax rules, one of the panelists said that though a political agreement has been received from 137 countries, the framework still needs to be delivered on a country-by-country basis. There is likely to be a significant amount of policy change due to BEPS Pillar Two. From the EU perspective, the directive from the European Commission is likely to come by the end of December 2021. In the US, the package is pending Senate approval. The UK has adopted Pillar Two to get Pillar One.

Sharing an update on the interplay of new tax rules with the equalization levy and how we will look at the transition as we advance, Vijay Iyer said, “Most forms of equalization levy and unilateral measures will go away once Pillar One is implemented. Of course, all the relevant inland measures will be discussed.”

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Vijay Iyer

Conclusion

BEPS 2.0P is a historic agreement at the political level and a significant achievement of the inclusive framework to get 137 countries together and to agree. However, this is just the start of the journey. Turning this political agreement into a technical agreement is where much work needs to be done.

The source of the data for the figures shown is taken from the recording of the panel discussion from the EY Tax Policy Roundtable conducted in Dec 2021, the data is as spoken by the panelists.
India’s growth outlook remains optimistic but will require a consistent and concerted policy push.
Is India’s economy finally prepared to move past the persistent and reverberating challenges faced during the COVID-19 infested year 2020 and refocus all energies on a breakthrough FY22-23?

There are concerns about what the OMICRON variant of COVID-19 might do. However, based on available indicators, India is set for a pivotal return to growth and might even become one of the fastest-growing economies. Though Asia’s third-largest economy is growing faster than developed nations, economic problems in India still loom. Fixing these problems will take sustained efforts on the part of the Government.

This brings us to the next question: What priorities will the Government set to fuel economic growth and development in India?

To answer this question and many others, EY organized a roundtable to discuss the potential and risks facing the Indian economy. The roundtable was moderated by Sudhir Kapadia, EY India Tax Leader, joined by Ila Patnaik, Economist and Professor, NIPFP, and DK Srivastava, EY India Chief Policy Advisor.

The experts deliberated over India’s economic outlook and strategies to deal with emerging challenges such as the new OMICRON variant, supply chain disruptions, climate concerns and rising input costs that could dampen the country’s growth. The experts also shared growth trends and discussed policy measures needed to uplift growth in the mid-to-long term.

Though the ongoing COVID-19 pandemic continues to pose questions about India’s economic growth into 2022 and beyond, the Reserve Bank of India has retained the country’s GDP growth forecast at 9.5%. However, it also cautioned that the economic recovery is not strong enough to be durable and self-sustaining.

4. Reserve Bank retains GDP growth forecast for current fiscal year at 9.5% | Business Standard News (business-standard.com)
According to a report by the Centre for Economic and Business Research, India may overtake France in 2022 to become the sixth-largest economy in the world. The same report also highlights that the US$22 trillion GDP of the United States is larger than the combined GDP of 150 countries. And just four countries – the US, China, Germany, and Japan – account for over 50% of world GDP. The feel-good factor is that the report predicts India to overtake Germany by 2031 to become the third-largest economy in the world with a GDP of more than US$6.8 trillion. The World Economic League (WEL) estimates that India will overtake all European countries to become the third-largest economy in 2031. But where will this growth come from, and what factors and strategies will drive this growth?

Answering this question, one of the panelists said, “growth won’t come by imitating China.” This is because what China did three decades ago, in a different world with different technology, strengths and demographics, cannot give us the same growth trajectory today. We will need to be far more acutely aware of our carbon footprint to achieve similar growth. The second factor is technology. When China built infrastructure 30 years ago, it relied on a large labor force. Today, with changes in technology, we can have robotics replace that large labor force. The third factor is culture. While there is some large-scale production in India, the need to discipline our workforce to match the quality produced by the Chinese workers is immediate. The biggest factor that will drive long-term growth in India is our demographics - our young, English-speaking population.

5. India to become 3rd largest economy in 2031, says CEBR - CEBR
6. World economy now set to surpass $100 trillion in 2022 - Times of India (indiatimes.com)
Can India aspire to be a developed country without a solid manufacturing base?

India has enormous untapped potential to become a global manufacturing hub, but for decades, the service sector has been the driving force in our country's economic growth. Also, growth in manufacturing has been abysmal despite cheap labor and other resources.

While there has been an uptick in manufacturing growth recently, it still needs more push — something the Government must focus on if it wants to ensure steady economic growth.

However, according to one of the panelists, India’s strategies to boost the manufacturing sector will have to be different from that of China. We will need to develop different reforms, particularly the financial sector and banking reforms, that will help boost small-scale manufacturing instead of large-scale. Several Banking Committee reports have also indicated that making credit available to smaller industries might become vital to accelerating manufacturing in India. Making credit available to small-scale firms means two things:

1. Larger firms should go to a bond market, which means that there needs to be a bond market. As the Government is often the biggest player in the bond market, it would create an ecosystem by setting up the Public Debt Management Agency (PDMA).

2. Banks should lend money to SMEs and help them grow. This would lead to healthy competition in the industry where banks compete to find the best projects to invest.

Future of Indian economy: brighter days ahead

There are optimistic forecasts’ of India’s GDP growth rate in fiscal 2023, ranging from 7.5% (the Prime Minister’s advisory council) to 8.5% (IMF) and 9.1% (Goldman Sachs). After successive waves of the paralyzing COVID-19 pandemic and its variations, this news is a treat to sore eyes.

Adding to this optimism, Dr. D.K. Srivastava, EY India Chief Policy Advisor, said, “The Indian economy is showing significant shoots of revival, with different agencies predicting a strong growth in FY21-22 and FY22-23. So, chances are we would be leading the global growth performers, including China, provided we play our cards well.”

Commenting on India’s manufacturing capabilities, Dr. Srivastava said that we must be Atmanirbhar (self-reliant) in defense manufacturing, even if that requires a relatively large incremental capital-output ratio. The demographic changes in the country mean that India would have a competitive advantage to substitute for the aging population across the world by our young population.

Shifting the conversation to India’s immediate growth prospects, Dr. Srivastava said, “With real GDP growth projected by the RBI at 17.2% for the first quarter and 7.8% for the second quarter of FY22-23, country’s economy is relatively well-positioned on the path to recovery. Both IMF and OECD are forecasting a medium-term growth in the range of 7%, which I think is eminently feasible provided we are willing to reconsider and recalibrate our fiscal consolidation path.”

“We may not reach China’s growth levels, but if our growth rate could be pushed to over 8%, and if we can support that by suitable fiscal and monetary policies, we can look forward to the remaining part of the century as India’s century,” he concluded.

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Conclusion

With a large young population, a booming economy and huge untapped potential to become the global manufacturing hub, India is at a critical juncture in its growth trajectory. However, to claim its rightful place on the world map, India needs to rethink its fiscal and monetary policies. Of course, there are climate-related challenges, new COVID mutations, and legacy issues of poverty and healthcare, but India has the best chance to better these problems.
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