

# **India's Macro-economic Policies : Past Experience and Challenges Ahead**

*by*

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# Some Key Reasons to Focus on Growth Prospects

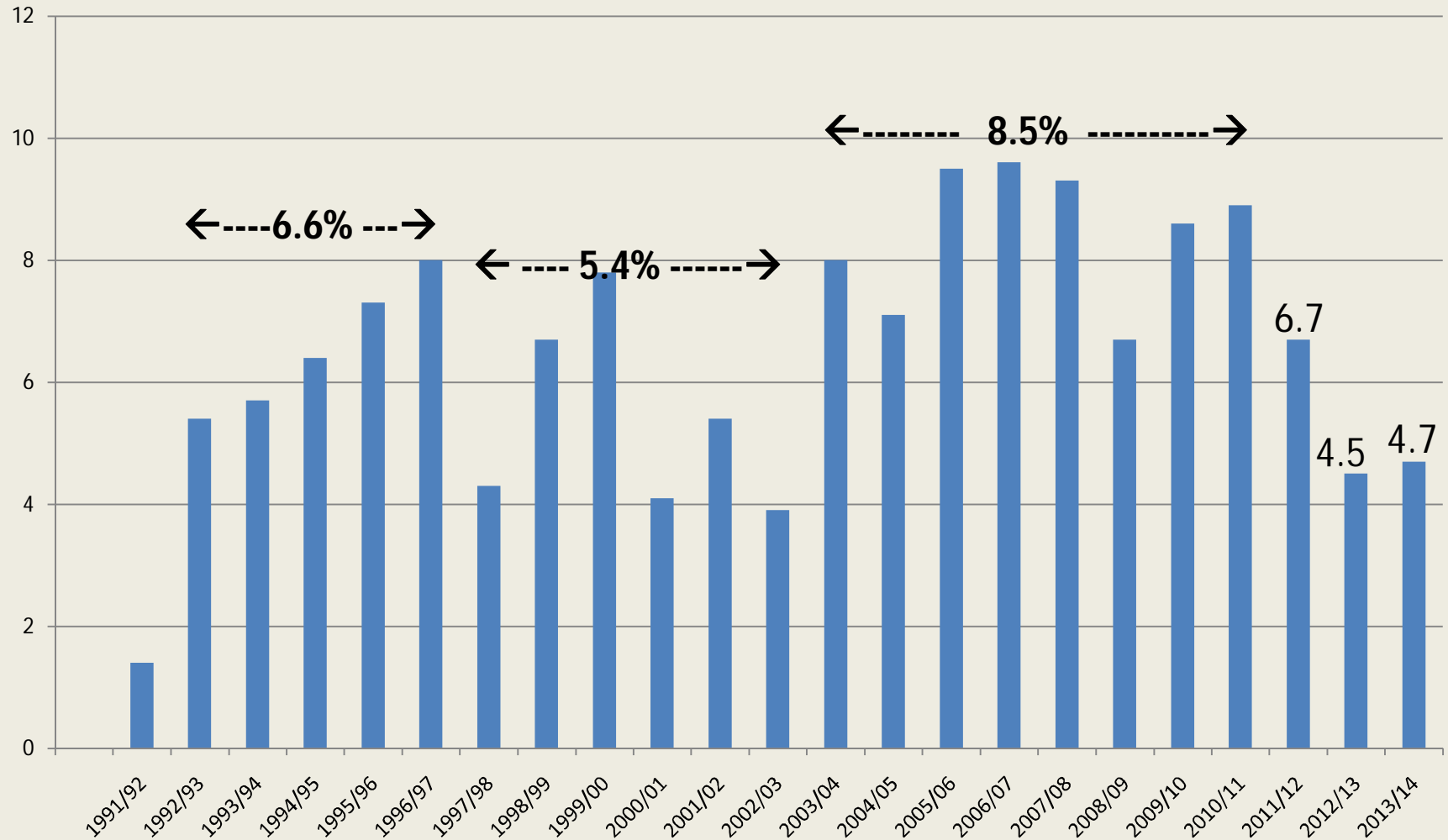
- Growth is the key to economic well-being, poverty alleviation and strategic security.
- After effects of Global Financial Crisis still slowing Industrial Countries and now also affecting Emerging Countries.
- Long-predicted China slowdown is clearly happening in last 2 -3 years, especially in past year.
- New World of e-commerce, 3-D printing is upon us
- New Government in place since May 2014.
- We no longer have an official Planning Commission.

# Past record on Growth by decades

1952 /53	–	1959/60	3.8	“Hindu Rate of Growth”
1960 /61	–	1969/70	4.0	
1970 /71	–	1979/80	3.0	
1980 /81	–	1989/90	5.6	
1990 /91	–	1999/2000*	6.3	
2000 /2001	–	2009/10	7.2	

\* Omits crisis year of 1991/92

# India's GDP growth since 1991/92



Source : CSO (2004/5 base)

# THE HALCYON YEARS, 2003 - 8

	2003/4–2007/8	1992/3–1996/7
Economic Growth (% per year)	8.7	6.6
Inflation (GDP deflator, % per year)	5.6	9.1
Current Account Deficit (% of GDP)	0.3	1.1
Combined Fiscal Deficit (% of GDP)	6.3	7.1
Gross Domestic Investment (% of GDP)	33.8	24.2

## **Key Points/ Trends**

- 5 Year growth at all-time high (compare previous 5 year high)
- Inflation moderate
- Current account deficit low
- Combined fiscal deficit down from 8.5% of GDP 2003/4 to 4% in 2007/8
- Gross Investment surges from 27% of GDP in 2003/4 to 38% in 2007/8
- Supported by strong domestic savings surge.

# Major Causes of 2003–8 Growth / Investment Boom

1. Cumulative **reforms of 1991 – 2003**. Private sector boom in new globalized environment.
2. Liquidity-fuelled **Global boom of 2002 – 2007**. Boosted **international trade, capital flows and technology transfer**.
3. **Strong fiscal consolidation** of 2003 –2008 (FD down from 9.6% of GDP in 2002/3 to 4.1% in 2007/8) meant **lower interest rates** and **ample availability of funds**. Fuelled high investment.
4. **Surge in domestic savings** because of big **drop in government dis-savings** and strong **rise in corporate savings**. **Gross investment rate surged from 25% of GDP to over 35%**.
5. **Caught the global boom in services** (IT, Telecom, Finance etc.). India's service exports increased @ 25% per year between 2001 and 2008.
6. Deft **management of exchange** rate, till 2007. Prevented excessive appreciation of rupee despite surge in Capital inflows.

# India's Growth Resilient in Crisis

Country	2005–07	2008	2009	2010
<b>World output<sup>a</sup></b>	<b>3.8</b>	<b>1.6</b>	<b>-2.1</b>	<b>4.2</b>
<b>Advanced economies</b>	<b>2.8</b>	<b>0.2</b>	<b>-3.4</b>	<b>3.2</b>
United States	2.6	0.0	-2.6	3.0
Euro area	2.6	0.4	-4.1	1.9
Japan	2.1	-1.2	-6.3	4.4
<b>Emerging-market and developing economies</b>	<b>8.1</b>	<b>6.1</b>	<b>2.8</b>	<b>7.5</b>
Russia	7.7	5.2	-7.8	4.3
China	12.7	9.6	9.2	10.4
<b>India<sup>b</sup></b>	<b>9.5</b>	<b>6.7</b>	<b>8.6</b>	<b>8.9</b>
Brazil	4.4	5.2	-0.6	7.5

a. At market exchange rates.

b. For India, the years are April to March financial years, so 2008 refers to 2008–09 and so on for subsequent years.

**Sources:** International Monetary Fund, *World Economic Outlook (WEO)*, April 2011, for data up to 2008; WEO Update (June 2011) for 2009; and WEO Update (July 2012) for 2010 onward. Data for India are from the Central Statistical Organization.

# Reasons why India's Growth resilient in Global Crisis

- **Momentum of rapid growth and high investment in 2003–8.**
- **Transmission channels of global financial crisis blunted** by conservative financial sector policies of RBI; strong regulation of banks; cautious approach to Capital Account Convertibility, etc.
- **Extraordinary fiscal profligacy of Central Govt. in 2008** on wage increases (6<sup>th</sup> Pay Commission), huge subsidies (food, fuel, fertilizer), roll-out of entitlement programmes (NREGA) and farm loan waiver. **Centre's fiscal deficit soared from 2.5% of GDP (budgeted) to 8% of GDP !**
- **RBI quick to sharply reduce policy rates** and boost domestic liquidity (Repo rates dropped from 9% in Sept. 2008 to 3.25% in April 2009). Also allowed exchange rate to depreciate.
- **Initial promising recovery of global economy** in late 2009 and 2010.



# But Macro-Indicators weaken after 2008

Indicator	Average (2003/4 to 2007/8)	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13	2013/14
<b>Economic Growth (GDP, Percent per year)</b>	<b>8.7</b>	<b>9.3</b>	6.7	8.6	<b>8.9</b>	6.7	<b>4.5</b>	<b>4.7</b>
<b>Inflation (GDP deflator, percent per year)</b>	<b>5.6</b>	<b>6.6</b>	8.8	7.5	10.5	8.7	<b>8.2</b>	<b>8.0</b>
<b>Current account balance (percent of GDP)</b>	<b>-0.3</b>	<b>-1.3</b>	-2.3	<b>-2.8</b>	<b>-2.7</b>	<b>-4.2</b>	<b>-4.8</b>	<b>-1.7</b>
<b>Combined Fiscal Deficit (percent of GDP)</b>	<b>6.3</b>	<b>4.1</b>	<b>8.5</b>	<b>9.5</b>	<b>7.0</b>	<b>7.8</b>	<b>6.9</b>	<b>6.6</b>
<b>Gross Domestic Investment (percent of GDP)</b>	<b>33.8</b>	<b>38.1</b>	34.3	36.6	36.8	35.4	<b>35.6</b>	<b>33.7</b>
<b>Gross Fixed Investment (percent of GDP)</b>	<b>29.6</b>	<b>32.9</b>	32.3	31.6	31.7	30.6	<b>29.6</b>	<b>29.0</b>
<b>Gross Domestic Savings (percent of GDP)</b>	<b>33.4</b>	<b>36.8</b>	32.0	33.8	34.0	<b>31.2</b>	<b>30.8</b>	<b>32.0</b>

Sources: Central Statistical Organization and Reserve Bank of India

# Major Causes of Weakening Macro Performance

- 1) **Little by way of productivity raising reforms** during 2004 - 2014.
- 2) **Global environment continues weak** post 2007-9 global crisis.
- 3) **Exit from fiscal spending/ deficit surge of 2008/9 proving difficult.**  
Keeping inflation and medium-long interest rates high.
- 4) **Drop in domestic savings** because of high government dis-saving and decline in corporate savings.
- 5) **Mismanagement of exchange rate** in 2009 -12: excessive nominal and real appreciation fuelled rising trade and current account deficits and hurt industry.
- 6) Emergence of **serious scams** (spectrum, coal mining, big projects) and “coalition compulsions” **distracted and stalled governmental decision-making.** #
- 7) **Tightening regulatory and pricing bottlenecks** in energy, mining, land allocation, and Telecom. #
- 8) Tax Policy shocks of 2012. #

#  
Supply  
Shocks

# How Fast is India Growing?

## Differences in Growth and Sectoral Shares of GDP (GVA)

Shares in Current  
Prices

Growth at constant prices

(Average of 2011-12 and 2012-13)		Sectors	2012 - 13		2013 - 14		2014 - 15	
2004-05 Base	2011-12 Base		2004-5 Base	2011-12 Base	2004-5 Base	2011-12 Base	2004-5 Base*	2011-12 Base
17.7	18.2	Agriculture/Forestry / Fishing	1.4	1.2	4.7	3.7	3.5	1.1
14.4	18.0	Manufacturing	1.1	6.2	-0.7	5.3	1.8	6.8
17.3	11.1	Trade/Hotels/ Restaurants	4.5	10.3	1.0	13.3	3.3**	8.4**
16.9	19.2	Finance /Real Estate / Business Services	10.9	8.8	12.9	7.9	10.0	13.7
<b>100.0</b>	<b>100.0</b>	<b>Total GDP (GVA)</b>	<b>4.5</b>	<b>4.9</b>	<b>4.7</b>	<b>6.6</b>	<b>5.5</b>	<b>7.5</b>

Sources: : Central Statistical Office

### Notes:-

\* Data in this column are growth rates for first half of 2014-15; second half not published on 2004-5 Base.

\*\* Data refer to wider sector, including Transport and Communications.

# Global Economic Prospects are weakish

<u>Country / Region</u>	<u>2014 GDP (\$ trillion)</u>	<u>Likely Growth (%) in next 2 - 3 years</u>
European Union	18.5	1.0 - 1.5
United States	17.4	2.5 - 3.0
China	10.4	6.0 - 7.0
Japan	4.6	1.0 - 1.5
"Big 4" (above)	50.0	2.0 - 2.5
<b>WORLD</b>	<b>77.0</b>	<b>2.5 - 3.0</b>

Note: In 2014 GDP in \$ trillion was **2.0 (India)**, 2.3 (Brazil), 1.9 (Russia), 1.8 (Canada)

Source: IMF

❖ **World Trade Growth** likely to remain slow : 2–3 %

**MORAL** -----> Must focus on DOMESTIC reforms and policies

# Ten major legacy constraints on India's Growth/Development

## Old (for 40 years plus)

- (1) Weak physical Infrastructure (electricity, roads, railways, ports etc.)
- (2) Misdirected approach to Agriculture: Subsidies instead of rural infrastructure and markets.
- (3) Dominance of Public Sector Banks (weak performance, governance, capitalization).
- (4) Inflexible Labour Laws (especially for Industry)
- (5) Neglect of public health and basic education
- (6) Unreformed administrative structures.
- (7) Neglect of Urban governance

## New (or strengthened) during UPA decade

- (8) Land Acquisition Act (2013)
- (9) “Excessive” Entitlement Laws (food, rural employment and education).
- (10) Crony Capitalism/High corporate borrowing/weak PSU Banks<sub>12</sub>

# Promising Initiatives of Modi Government (Year 1)

1. Reasonable **fiscal moderation**: abolition of diesel subsidy; Capping cooking gas.
2. Successful **inflation reduction**: Food Stock Sales; Moderation of MSPs; conservative monetary policy; good luck with slump in commodity prices.
3. Significant thrust to **Railway** Investment/finances (first passenger fare increase in 10 years) and efficiency; some revival of **Highways** programme.
4. Major drive for **Financial Inclusion** (Jan Dhan Yojana) and using expanded platform for low-end **insurance, pensions**.
5. Sustained efforts to amend unworkable 2013 **Land Acquisition Act**.
6. Promising **Labour law reforms** at Central and State levels.
7. Determined efforts to bring in **GST** by April 2016.
8. Reasonably successful conclusion of Supreme Court mandated **Coal block auctions**.
9. Completed amendment of **insurance laws** to raise foreign ownership cap to 49%.
10. Raised foreign investment cap in **defence industries** to 49%.
11. Amendment of old **Mines and Minerals Act** to enable auctioning.

# Slowing Reform Momentum in July- September 2015

## ***Setbacks to Major Reforms:***

- 1) Abandonment of **amendments to 2013 Land Act** in face of opposition from Joint Parliamentary Committee allies and farmer groups.
- 2) **.GST Constitutions Amending Bill** blocked by obstructive tactics in Rajya Sabha

## ***Slowdown in other Reforms:***

- 3) After success with cooking gas, no real progress with shifting **Major Subsidies** (Food, Fertilizer, Kerosene) to Direct Cash Transfer.
- 4) Promised **Labour reforms** stalled in committees.
- 5) Serious governance, under-capitalization and bad loan problems of **PSU Banks** not adequately tackled by “Indradhanush” initiative.

## ***Inaction or Back-Tracking***

- 6) Little action on **Shanta Kumar Committee** recommendations on FCI and Food Economy
- 7) **.Expenditure Commission reports** not even made public.
- 8) Budget promise of **Strategic Disinvestment** (Rs.28,500 crores) not delivered at all.
- 9) Plans to **privatize airports** in Ahmedabad, Kolkata, Chennai, and Jaipur dropped.  
“Minimum Govt.; Max Governance”?
- 10) Little progress in tackling huge **problems of SEB losses and outstanding debts;** crippling electricity sector.

## ***Revival of Fiscal Populism ?***

- 1) OROP and its repercussions .....
- 2) Seventh Pay Commission report looming .....
- 3) Big pre-election “special package” for Bihar. West Bengal, Assam, Kerala, Tamil Nadu to follow?

Stresses ahead for FISCAL PRUDENCE

# Speculations for Growth 2015 - 2020

- \* Government Promises early reversal to 8 – 10% growth, with 8% plus in 2015 – 16.
- \* Against background of earlier analysis (and data doubts), here are my speculations:

## **GDP(GVA) Growth (%) 2015 - 2020 (average)**

- |     |  |           |
|-----|--|-----------|
| (A) | Likely range for CSO outcomes  | 6.5 - 8.0 |
| (B) | What “it will feel like” in terms of other economic indicators. (Corporate earnings, bank credit, tax revenues, job scene, etc.) | 5.0 - 6.5 |



# WE NEED JOBFULL GROWTH

No time for this separate major topic

Situation is pretty desperate. See below  
(from India Express September 17, 2015)

“ 23 LAKH APPLY for 368 PEON posts in UP, including 250 **Ph.D.s**, 25,000 **Postgraduates** and 1.52 Lakh **Graduates.** ”

# Policy Priorities : Medium Term

- ❖ More flexible labour laws and better skill development to realize demographic dividend.
- ❖ Resist populism and strengthen fiscal prudence.
- ❖ Strengthen banking and credit systems.
- ❖ Improve exchange rate management in the face of Capital account Volatility.
- ❖ Revamp of energy sector policies.
- ❖ Reform of Land, Water and Natural Resource allocation systems.
- ❖ Make it much easier to start, conduct and close businesses.
- ❖ Meeting challenge of Urbanization.

**THE END**

**THANK YOU**