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# Growth with Stability, Inclusion & 8%+ Growth

ICRIER-Konrad Adenauer Stiftung

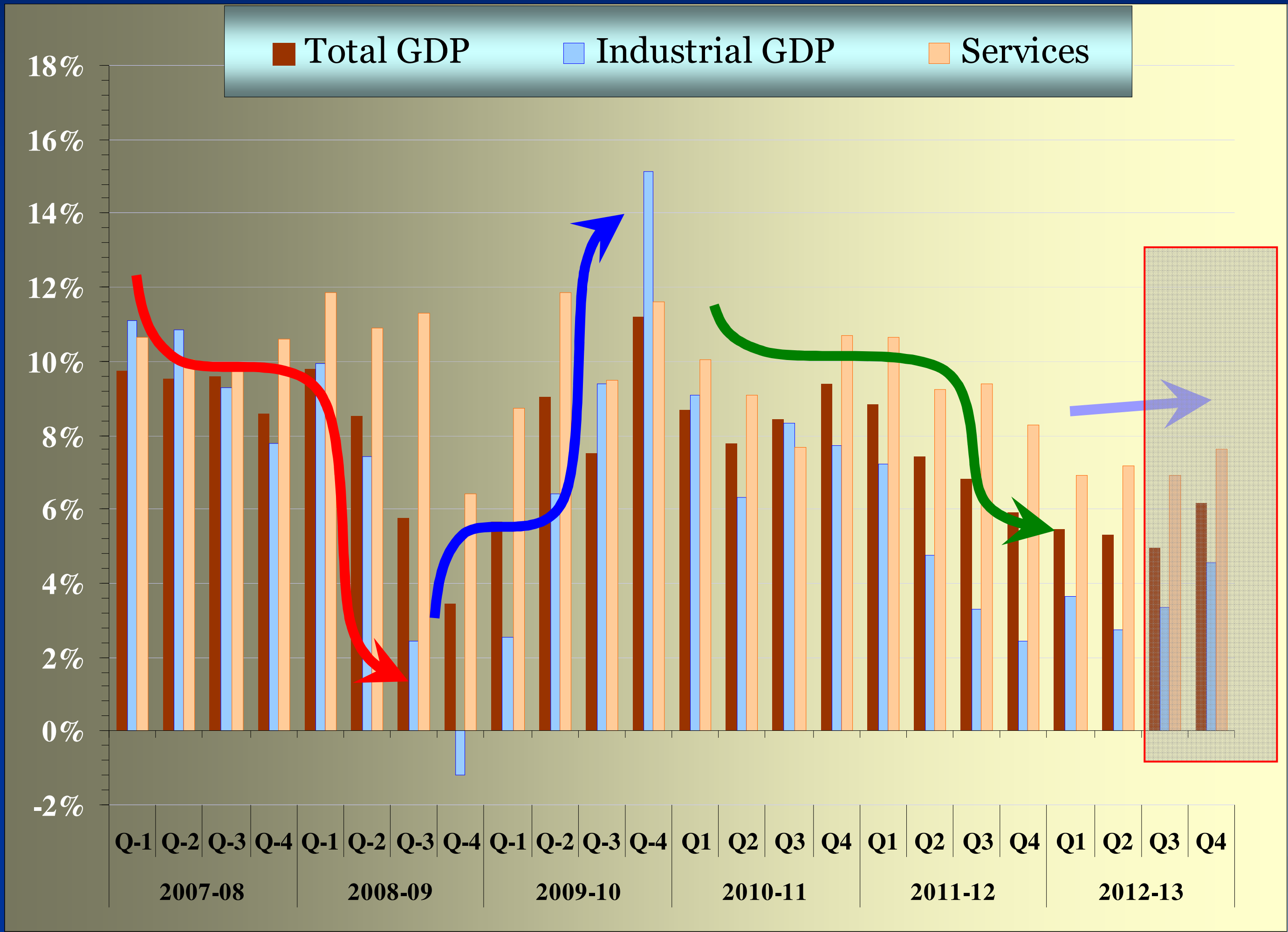
India Habitat Centre, New Delhi

Thursday, 21 February 2013

# Key Issues of Concern

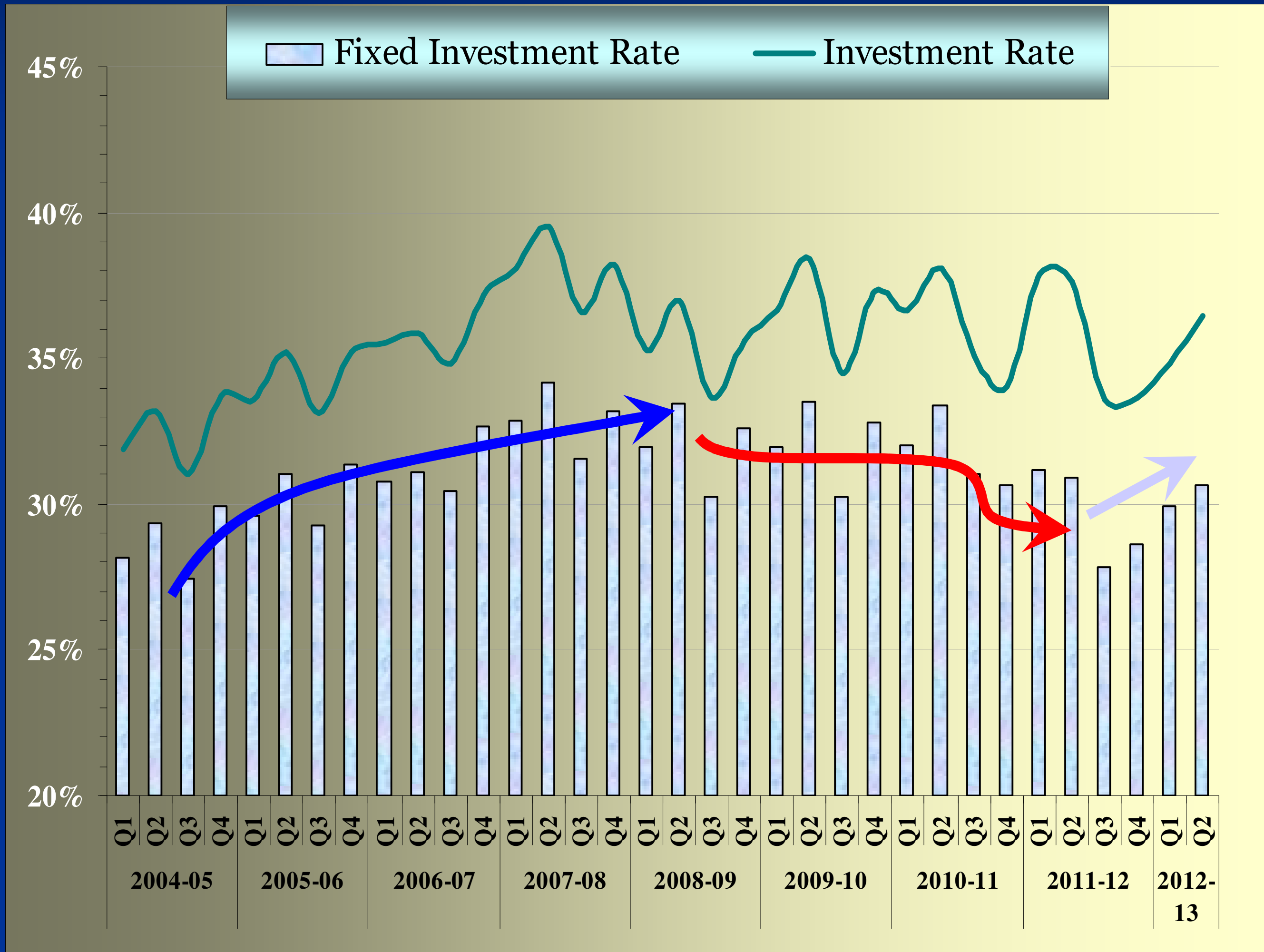
- Much quicker than expected recovery after global Crisis
- Then, a drawn-out slowing down of the economy
- Recovery in output growth was sharp, but that in the pace of investment was not as pronounced.
  - However, data shows that GFCF (peak 32.9% in 2007-08) was 31.7% on both 2009-10 and 2010-11. Now around 30%
- High inflation, persistence of large financing gaps in Central government and a much larger than desirable expansion in CAD have surfaced
  - All of these are unwelcome developments

# Quarterly GDP Growth Rates




Recovery far more rapid than expected, followed by unexpected deep & persistent slowing of growth

# Quarterly Investment Rates

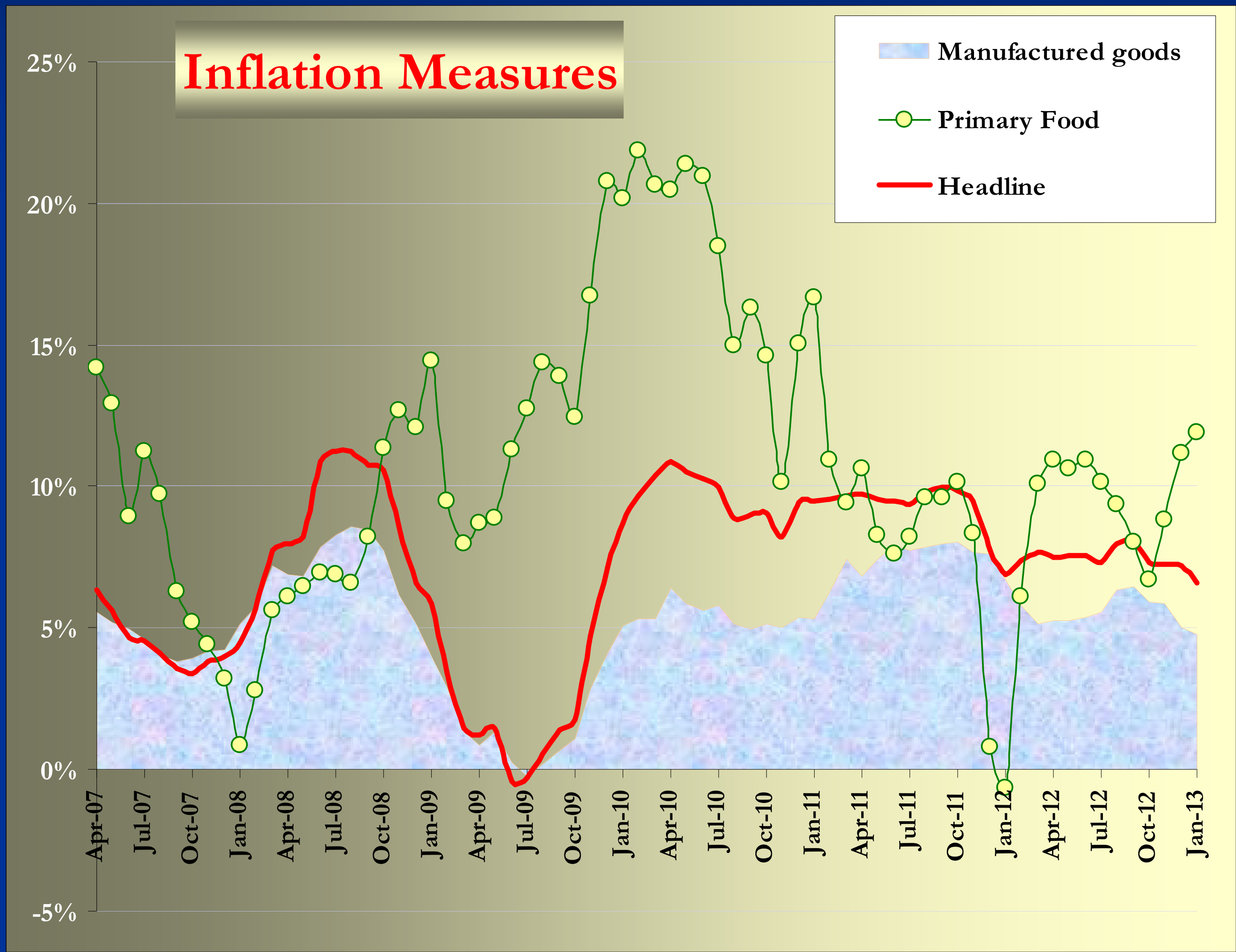



Fixed investment slowed a bit, but not by that much. More so in recent period

# Inflation added disruption …

- Impact of high and persistent inflation is strongly negative for growth.
- The sharp pick up in inflation into double digit levels lasting three years has resulted in
  - Lower corporate margins
  - Eroded real disposable income of consumer
  - Tightened monetary policy
- Political problems in recent years made matters worse

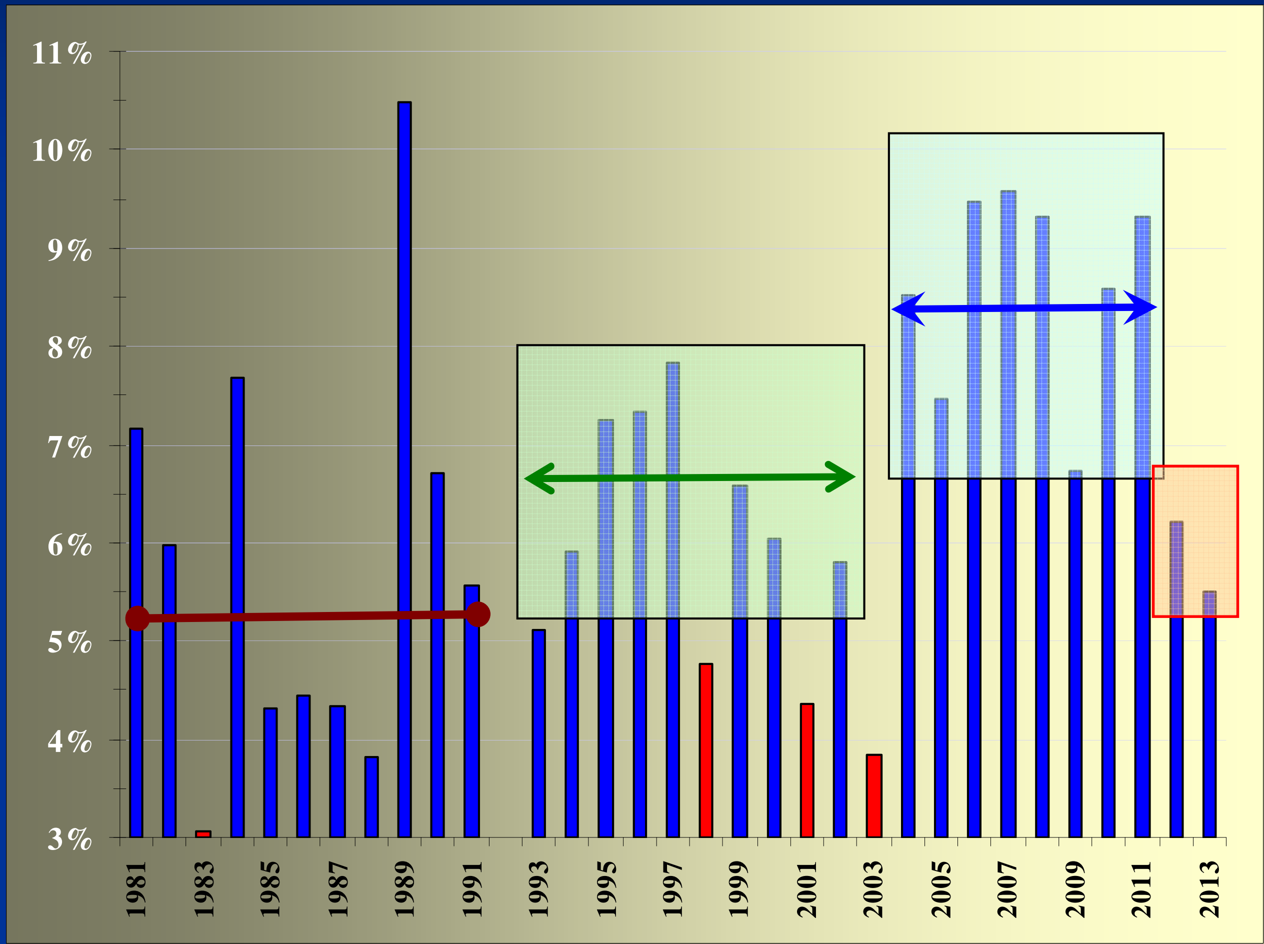
# Inflation for 36 months …




Surge in food prices in 2009 due mostly to the weakest monsoon in 28 years. It became generalized later. Some easing seen now

# The Break-out in Savings & Investment Rates as %GDP

# Variability & Shifts in GDP growth

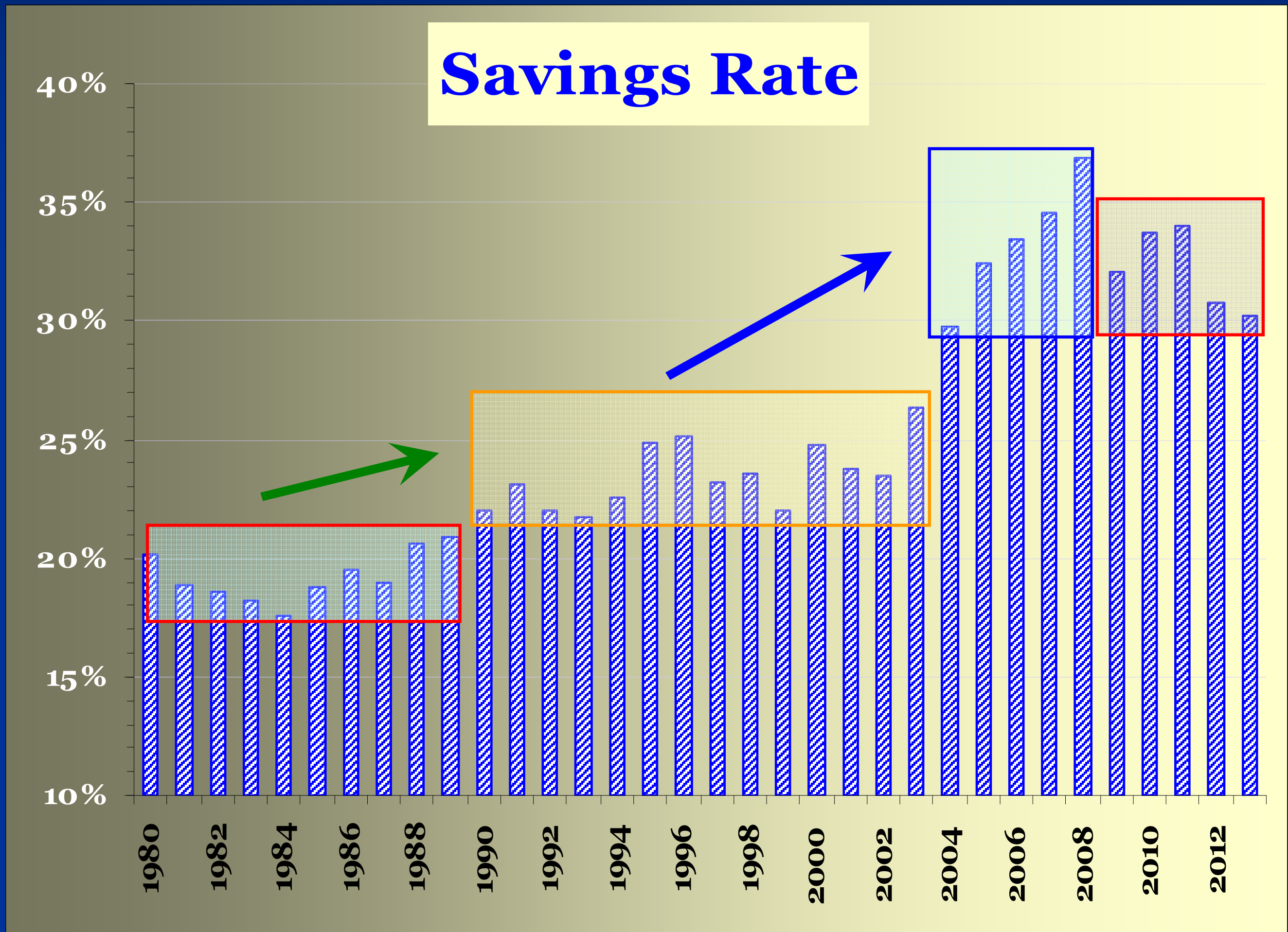



Growth an outcome of multiple factors. Hence, plenty of variability but this has reduced in recent years

# Structural changes …

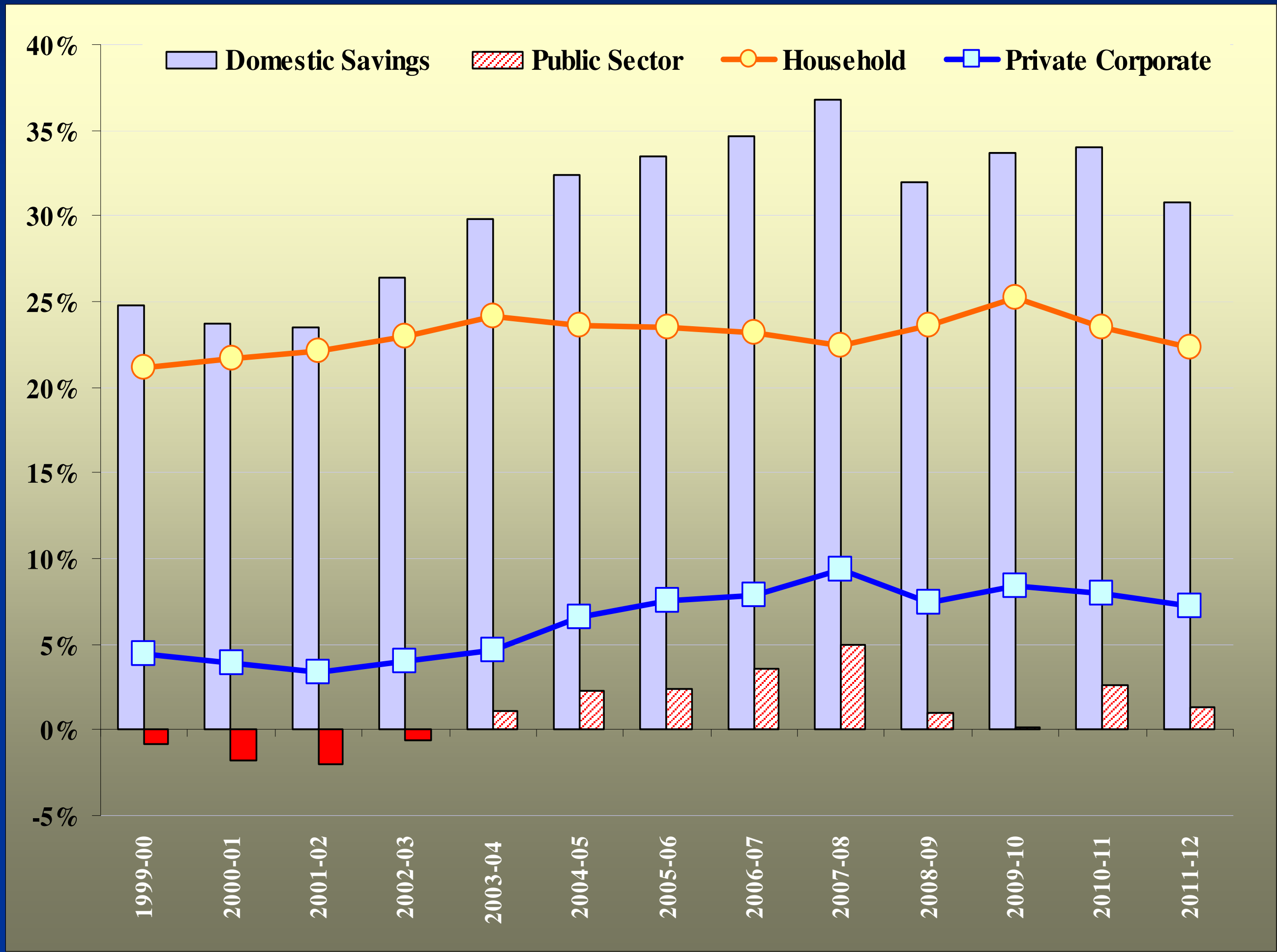
- Massive change in policy framework post-1991
- Large shifts in investment rates, including fixed capital formation
- Counterpart change in domestic savings rates
- Lower inflation
- Large changes in micro-level elements in corporate character, banking & in markets
- Larger private capital flows stabilized the BoP

# Savings rate moves into new levels



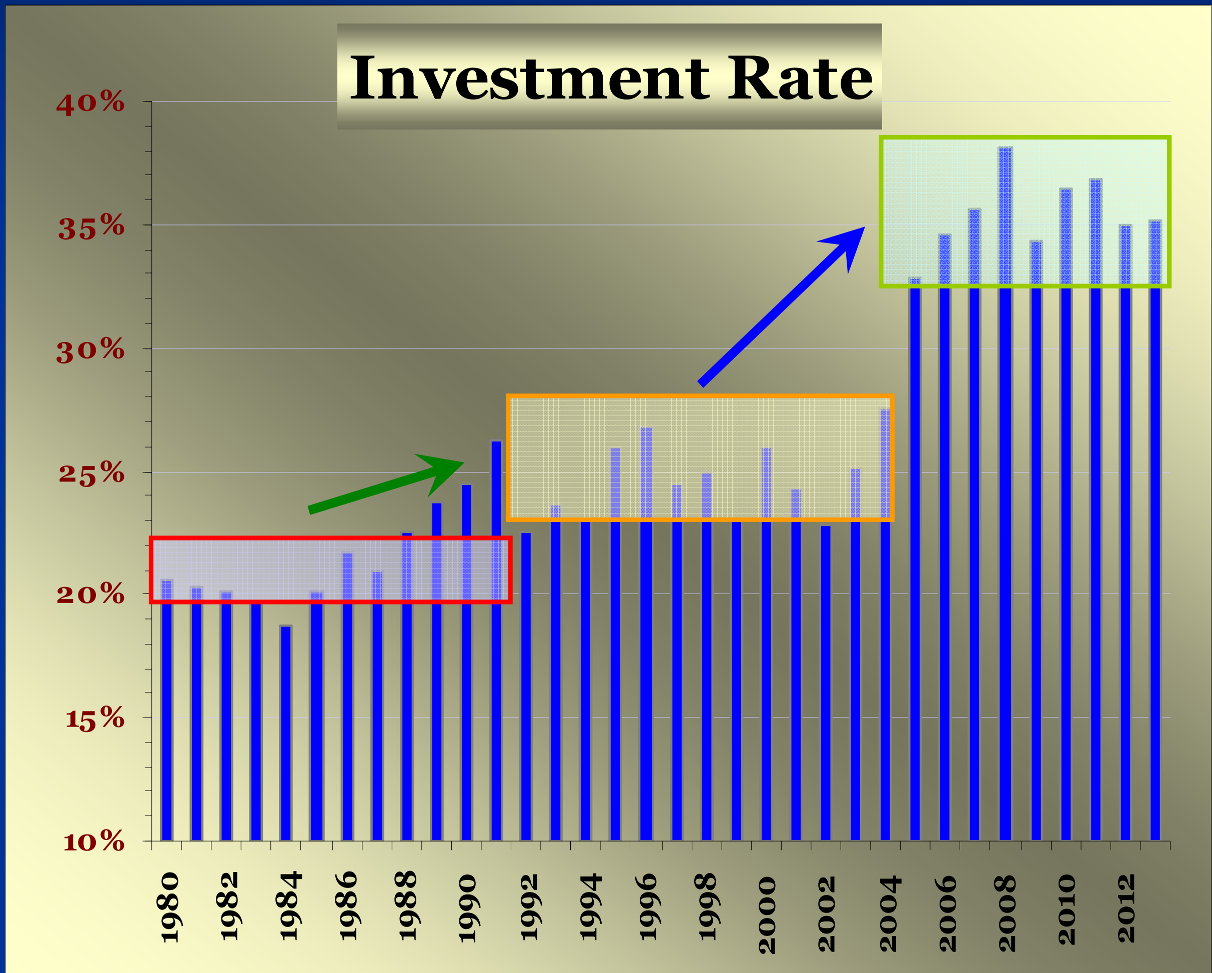

Clear and meaningful shift in domestic savings rates

# Components of Savings



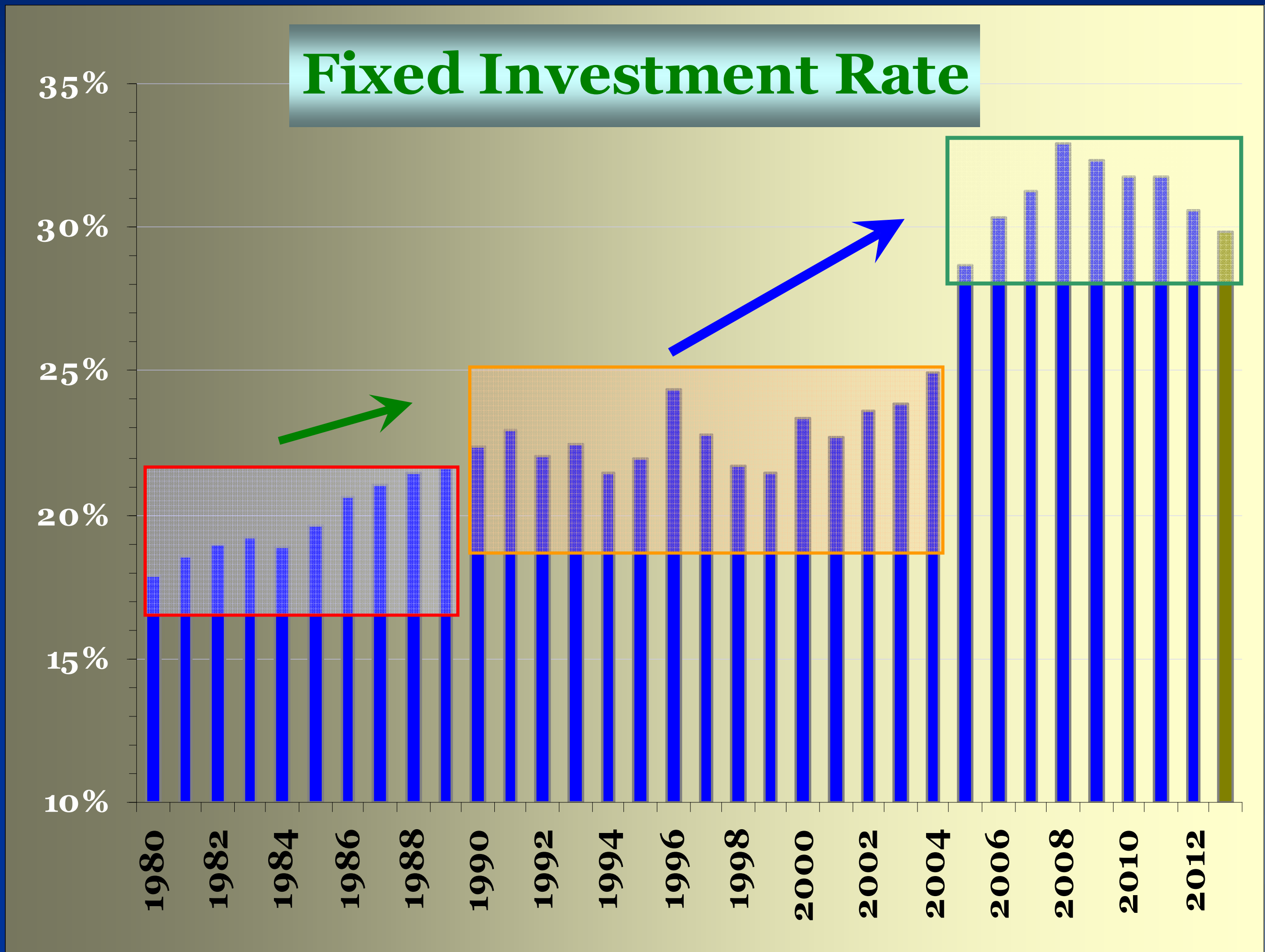

H/hold savings has settled at 23 to 25%. Fall in public sector savings main factor in pushing savings down savings rate. Weaker co. profits contributed

# Aggregate Investment picture



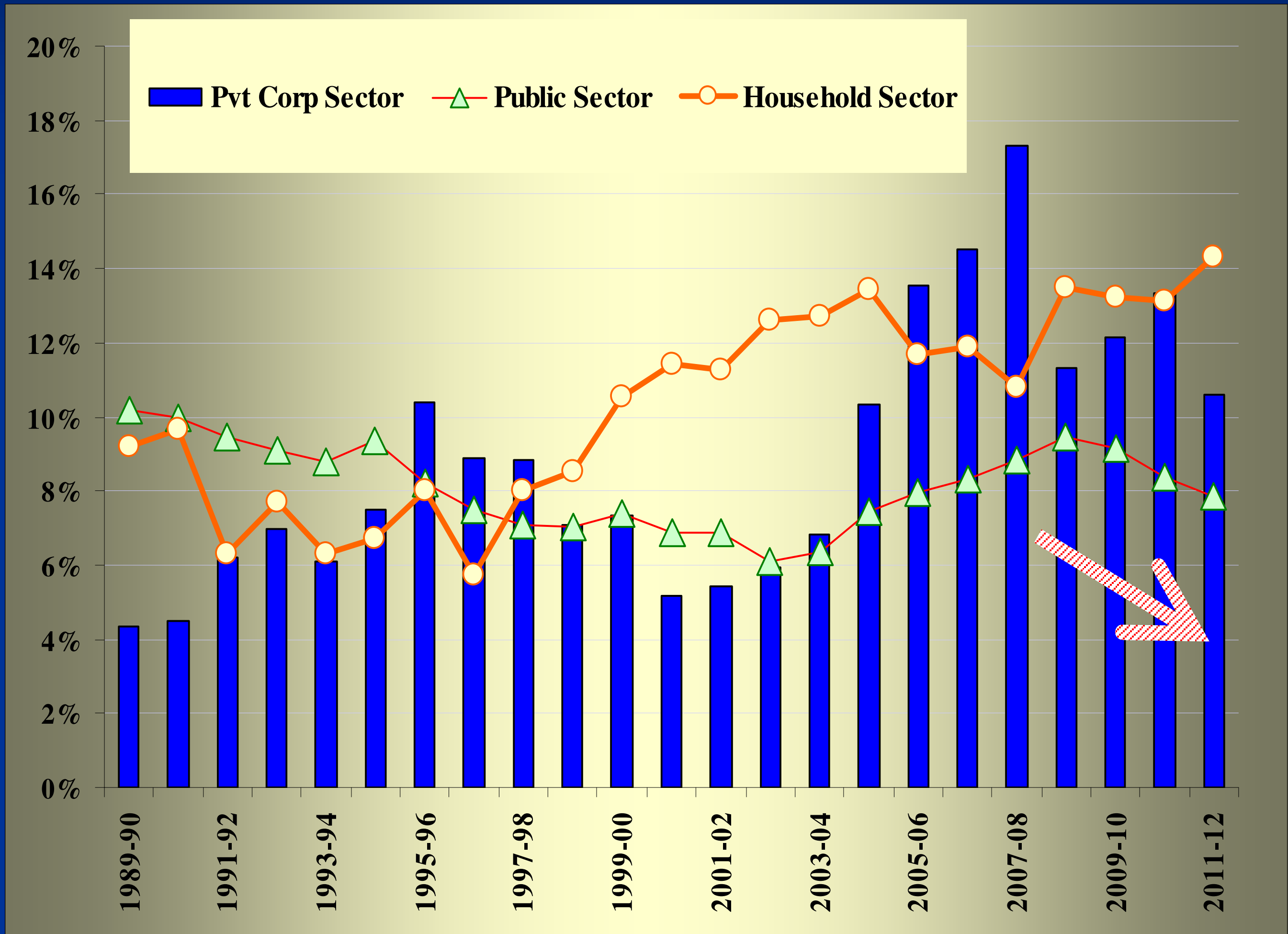

1. Investment has shifted massively
2. Presently, GDCF still substantial at ~35% of GDP. But this is a bit misleading

# The Fixed Investment Picture




Because disposition of that investment is less helpful to lifting growth. But it is still in the breakout region

# Fixed Investment–Where is the fall?

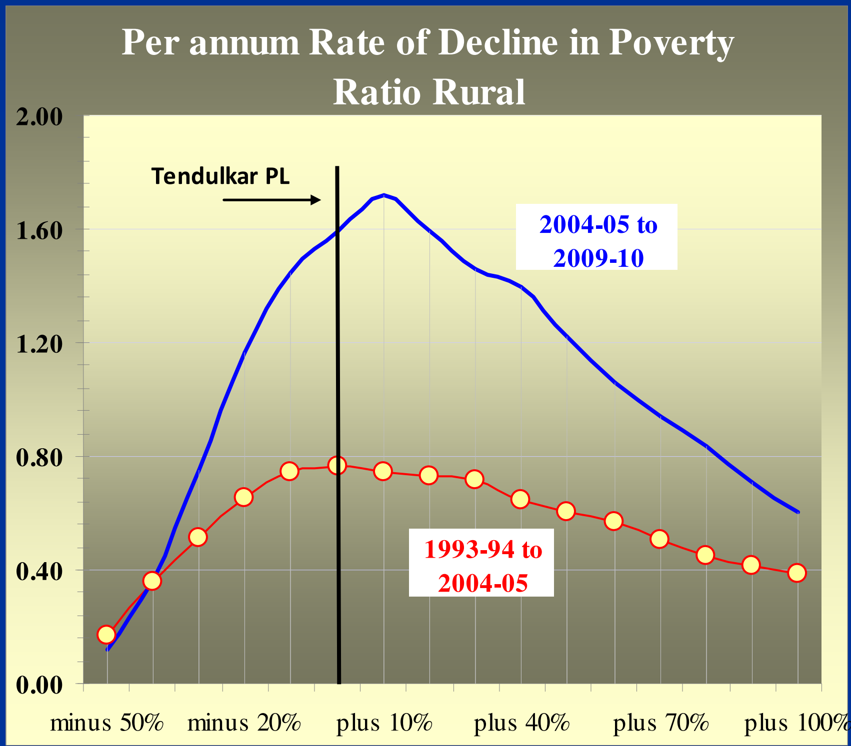


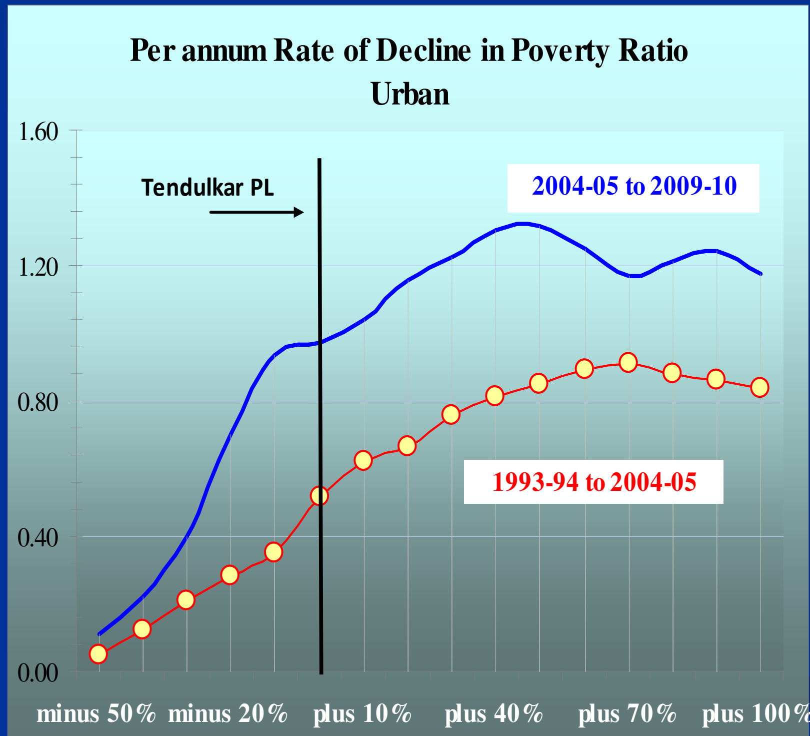

Largest decline in private corporate sector, but also a marginal one in the public sector

# Inclusion Issues

# Rate of Decline in Poverty Ratio

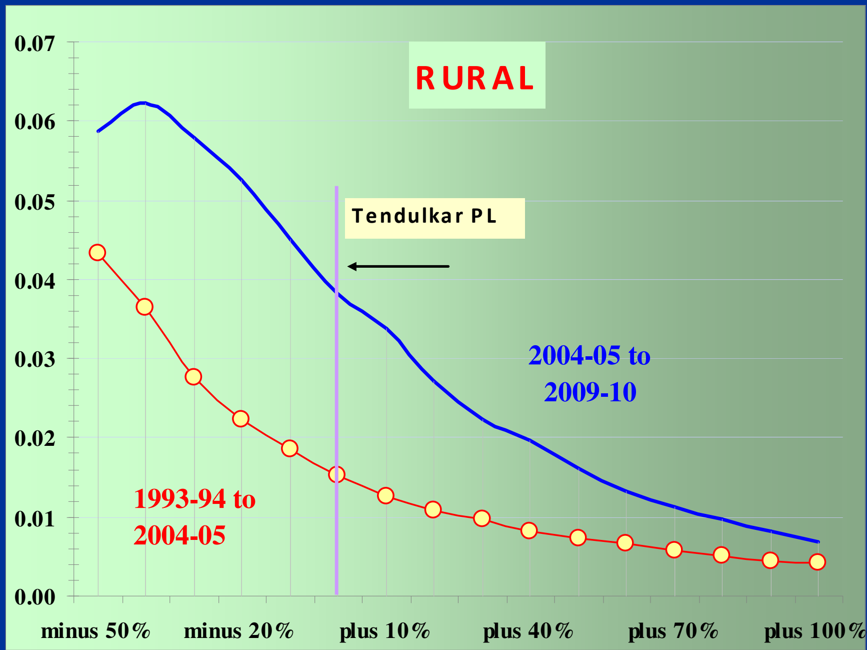
## Comparison of two time periods

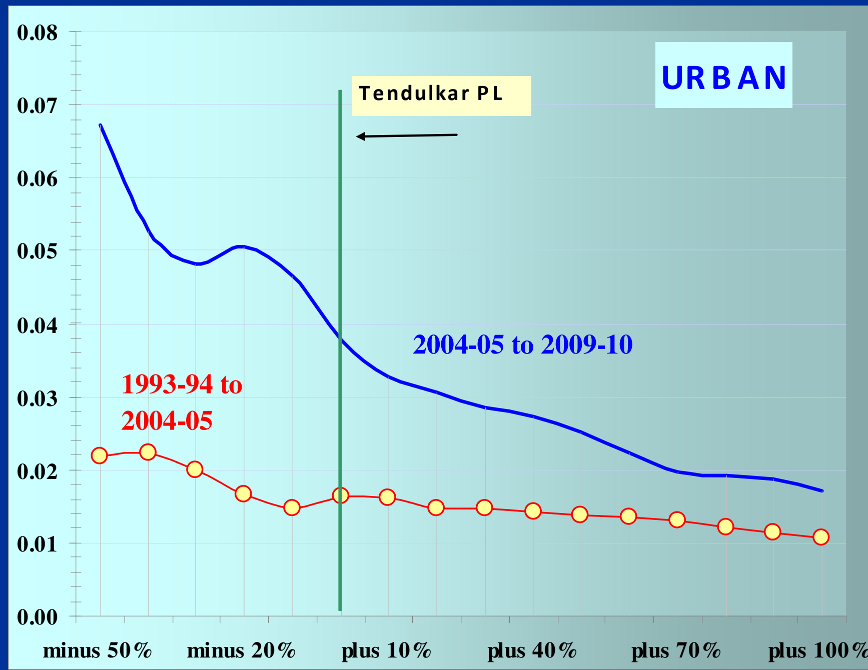


# Rate of Decline in Poverty Ratio

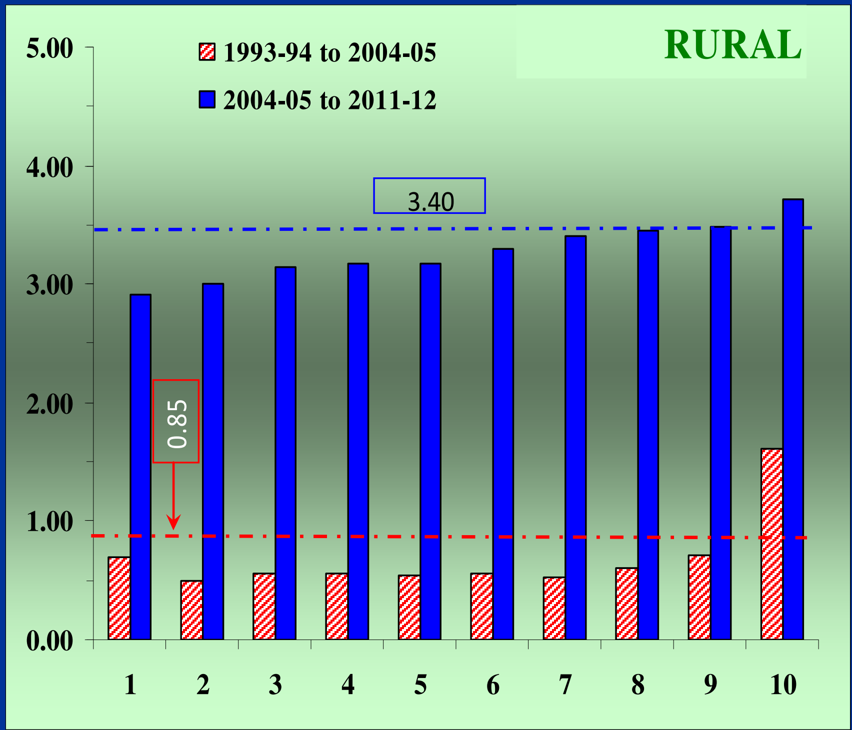
As per cent of previous period Poverty Ratio

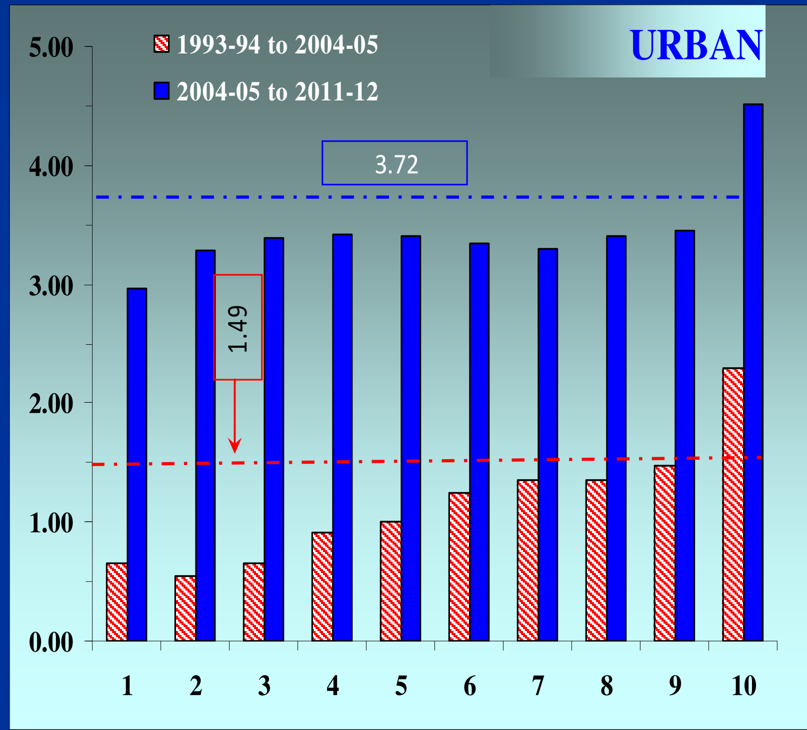


# Rate of Increase in MPCE (URP)

Two periods 1993/94 to 2004/05 and 2004/05 to 2011/12



# Path towards restoring 8%+ GDP growth rate

# Issues therefore are …

- Between 2007/08 and 2011/12, the rate of fixed investment has dropped:
  - By about 3 percentage points of GDP overall
  - By the 4 percentage points for the private corporate sector.
- Basic challenge is therefore to create conditions where this slippage is remedied in the next two years.
- To do this we need supportive policy, timely decision-making and effective & streamlined implementation of these decisions

# … and correct erosion in savings

- Fall of 6 ppt of GDP in savings rate between 2007/08 to 2011/12
- Of this 3.7 ppts was in public sector
    - Of which 2.5 ppts in in government administration
- Private corporate savings eroded by 2.2 ppts
    - Most of which was in 2010-11 and 2011-12. Corporate margins a function of restored growth, price & exchange rate stability
- Large decline in net financial savings of households – down by 3.6 ppt of GDP

# The problem . . .

- India is a supply constrained economy.
- Autonomous demand creation is substantial
- Keeping the supply in line with demand expansion however is a big challenge
- Therefore, inflationary pressures consistently plays a potent role in the Indian economy and is invariably destabilizing

# Point of Intervention

- The infrastructure space is the vital one as it defines the principal supply bottlenecks
- Then again, physical infrastructure
  - Involves government in diverse manners
  - It is also an area where government is able to intervene through many channels
- Therefore restoring the slippage in the fixed capital formation rate is (a) vital and (b) essentially a story of facilitating higher private investment in infrastructure

# Sectoral approach ….

- Largest chunk of infrastructure is in power. What do we need to do?
  - Clearances
  - Fuel supply
  - Transmission
  - Finances of Elect. Dist Coms, SERC and tariff revision
  - Financing
- Likewise for roads, ports, airports, railways and urban municipal infrastructure

# Macro side progress & task ..

- Linked to bringing Central govt.'s financing gap to ~5% of GDP in 2013/14 which will set it back on the path of consolidation
- Better tax revenues and substantial containment of expenditure, especially oil subsidies – required
- Tighter fiscal stance will (a) release more domestic savings for Capital formation; (b) improve anti-inflationary stance; (c) improve investment climate
- Work to reduce the demand for gold as an asset

# In Summary ….

- With a weak-*ish* global economic environment and in the **absence of shocks**, we can hope to return to 8%+ growth, provided we:
  - (a) are able to restore slippages in infrastructure investment and (b) get on *re*: pillars of macro economic stability
  - That is years 2013, 2014 . . .
- In a more favorable climate where conditions in the US & Europe improve, we can expect to build upon this foundation to target 9%
  - That is 2015 onwards ….

# So what does the 12th Plan look like?

- Short-run – in a weak global environment, but strengthened domestic activity and a recovery in investment in physical infrastructure:
  - Fixed investment rises slowly to hit 31% in second year of Plan period and up to 32% in the third year
  - Main agency of improvement in corporate sector including PPP.
- Medium-term – with recovery in global situation after 2014 and a more solid base at home, we can look to growth of 9% in the last two years of the 12th Plan.
- Average of 5 years can thus be around 8%, pulled down by the unexpectedly weak outcome in the first year

Thank you

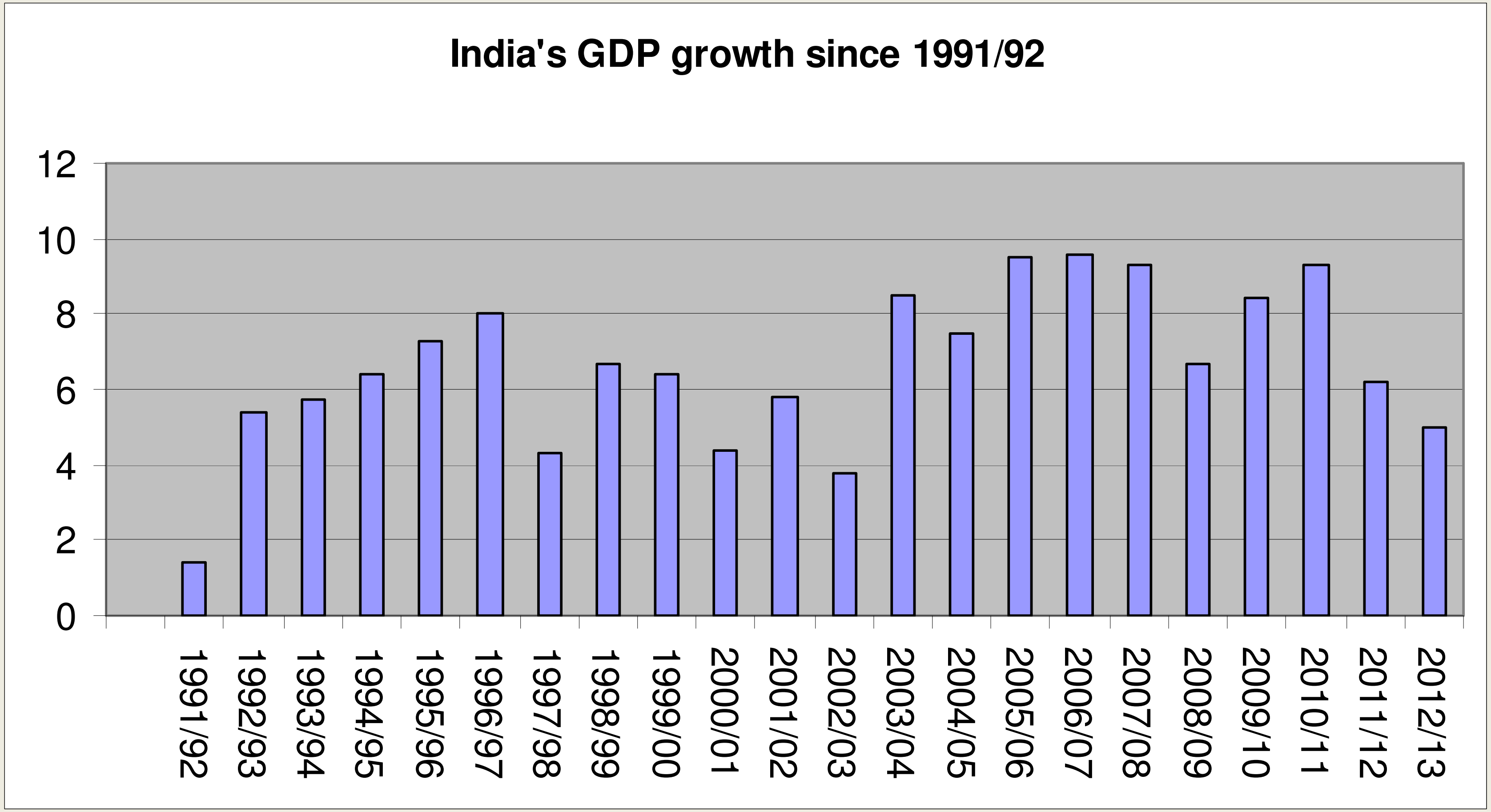
# Macroeconomic Context and Budget Priorities 2013-14

***by***

***Shankar Acharya ****

ICRIER – KAS Seminar 2013, ***February 21, 2013***

* Honorary Professor, ICRIER (former Chief Economic Adviser to the Government of India, 1993-2001)


India's GDP growth since 1991/92
12
10
8
6
4
2
0
1991/92
1992/93
1993/94
1994/95
1995/96
1996/97
1997/98
1998/99
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2001/02
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
2008/09
2009/10
2010/11
2011/12
2012/13

# 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 Capial inflows.

# India's Growth Resilient in Crisis

| Country | 2005–07 | 2008 | 2009 | 2010 | 2011 | 2012 (projected) |
|---|---|---|---|---|---|---|
| **World output[a]** | **3.8** | **1.6** | **–2.1** | **4.2** | **2.8** | **2.7** |
| **Advanced economies** | **2.8** | **0.2** | **–3.4** | **3.2** | **1.6** | **1.4** |
| United States | 2.6 | 0.0 | –2.6 | 3.0 | 1.7 | 2.0 |
| Euro area | 2.6 | 0.4 | –4.1 | 1.9 | 1.5 | –0.3 |
| Japan | 2.1 | –1.2 | –6.3 | 4.4 | –0.7 | 2.4 |
| **Emerging-market and developing economies** | **8.1** | **6.1** | **2.8** | **7.5** | **6.2** | **5.6** |
| Russia | 7.7 | 5.2 | –7.8 | 4.3 | 4.3 | 4.0 |
| China | 12.7 | 9.6 | 9.2 | 10.4 | 9.2 | 8.0 |
| **India[b]** | **9.5** | **6.7** | **8.4** | **9.3** | **6.7** | **5.0** |
| Brazil | 4.4 | 5.2 | –0.6 | 7.5 | 2.7 | 2.5 |

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.

# Factors Explaining Resilience

- 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$^{th}$ 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 | 20010/11 | 2011/12 | 2012/13 |
|---|---|---|---|---|---|---|---|
| **Economic Growth (GDP, Percent per year)** | **8.7** | 9.3 | 6.7 | 8.6 | **9.3** | **6.2** | **5.0** |
| **Inflation (GDP deflator, percent per year)** | **5.6** | 6.6 | 8.8 | 7.5 | 10.5 | 8.7 | 8.2 |
| **Current account balance (percent of GDP)** | **-0.3** | -1.3 | -2.3 | **-2.8** | **-2.7** | **-4.2** | **-5.0** * |
| **Combined Fiscal Deficit (percent of GDP)** | **6.3** | 4.1 | **8.5** | **9.5** | **7.0** | **8.2** | **8.0** * |
| **Gross Domestic Investment (percent of GDP)** | **33.8** | 38.1 | 34.3 | 36.6 | 36.8 | 35.0 | 34.0 * |
| **Gross Fixed Investment (percent of GDP)** | **29.6** | 32.9 | 32.3 | 31.6 | 31.7 | 30.6 | 30.0 |
| **Gross Domestic Savings (percent of GDP)** | **33.4** | **36.8** | 32.0 | 33.8 | 34.0 | **30.8** | **29.0** * |

**Sources: Central Statistical Organization and Reserve Bank of India**

*** Author's projections**

# Sectoral and Expenditure Contributions to Growth and Shares in GDP

| | Contributions to Growth (% share) | | | | Sectoral Shares (% of GDP) | | |
|---|---|---|---|---|---|---|---|
| | 1992-97 | 1997-2003 | 2003-08 | 2008-12 | 1990-93 | 2000-03 | 2009-12 |
| **Average GDP Growth (%)** | **6.6** | **5.4** | **8.7** | **7.5** | | | |
| **Sectors** | | | | | | | |
| Agriculture | 19.9 | 3.8 | 10.3 | 5.6 | 29.1 | 21.6 | 14.4 |
| Industry | 26.4 | 17.0 | 20.7 | 15.0 | 20.2 | 20.4 | 19.8 |
| Services | 53.3 | 79.9 | 68.7 | 79.6 | 50.7 | 57.9 | 65.8 |
| **Expenditure components** | | | | | **Expenditure Shares (% of GDP)** | | |
| | **1992-97** | **1997-2003** | **2003-08** | **2008-12** | **1990-93** | **2000-03** | **2009-12** |
| Private Consumption | 53.0 | 55.6 | 51.2 | 57.3 | 66.0 | 63.6 | 57.9 |
| Government Consumption | 8.5 | 13.9 | 7.3 | 14.0 | 12.0 | 12.7 | 11.2 |
| Gross Fixed Investment | 25.0 | 29.1 | 51.3 | 26.9 | 22.2 | 24.9 | 32.1 |
| Investment in Stocks & Valuables | -3.8 | 5.8 | 12.8 | 8.1 | 0.7 | 1.1 | 5.5 |
| Net Exports of Goods & Services | -7.7 | 0.7 | -10.6 | -16.1 | -0.9 | -2.2 | -6.7 |

**Source:** Reserve Bank of India, Handbook of Statistics on the Indian Economy, 2011-12
**Note** : The Contributions to growth" may not sum up to 100 percent, especially in respect of expenditure components because of substantial "discrepancies" in the data.

# Major Causes of Weakening Macro Performance

1) **Little significant reforms** since 2004.

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 -10: excessive nominal and real appreciation fuelled rising trade and current account deficits and hurt industry.

6) Emergence of serious scams (spectrum, mining, big projects) and "coalition compulsions" **distracted and stalled governmental decision-making**.

7) **Tightening regulatory and pricing bottlenecks** in energy, mining and land allocation.

# Crises Building in 2012 Summer

1) External liquidity (BoP) crisis.
2) Financial sector stresses.
3) Crisis in energy/ infrastructure sectors.
4) Prospect of slow (5 – 6%) growth for several years.
5) Bleak outlook on medium-term employment prospects for India's "youth bulge"; OR "demographic dividend" could became a nightmare.
6) Weakening of India's national security in a dangerous neighbourhood.

# Key Components of India's balance of payments (percent of GDP at current market Prices)

| | Component | 2003–04 | 2004–05 | 2005–06 | 2007–08 | 2008–09 | 2009–10 | 2010–11 | 2011–12 | 2012–13* |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | **Trade balance (A–B)** | **–2.2** | **–4.7** | **–6.2** | **–7.4** | **–9.7** | **–8.7** | **–7.8** | **–10.3** | **-11.0** |
| | A) Merchandise exports | **10.7** | 11.8 | 12.6 | 13.4 | 15.2 | 13.4 | 14.8 | 16.8 | |
| | B) Merchandise imports | **13.0** | 16.5 | 18.8 | 20.8 | 25.0 | 22.0 | 22.6 | 27.1 | |
| 2 | **Invisibles, net** | **4.5** | **4.3** | **5.0** | **6.1** | **7.5** | **5.9** | **5.1** | **6.1** | **6.0** |
| | *Of which:* | | | | | | | | | |
| | A) Software exports | **2.0** | 2.3 | 2.7 | 3.2 | 3.8 | 3.6 | 3.5 | 3.3 | |
| | B) Private transfers | **3.5** | 2.8 | 2.9 | 3.4 | 3.6 | 3.8 | 3.2 | 3.4 | |
| 3 | **Current account balance** | **2.3** | **–0.4** | **–1.2** | **–1.3** | **–2.3** | **–2.8** | **–2.6** | **–4.2** | **-5.0** |
| 4 | **Net capital inflows** | **2.8** | **4.0** | **3.0** | **8.7** | **0.5** | **3.8** | **3.4** | **3.6** | **4.5** |
| | *Of which:* | | | | | | | | | |
| | A) Foreign direct investment | **0.7** | 0.8 | 1.1 | 2.8 | 1.6 | 1.7 | 0.5 | 1.2 | |
| | B) Foreign portfolio investment | **1.8** | 1.3 | 1.5 | 2.2 | –1.1 | 2.4 | 1.9 | 1.0 | |
| | C) External assistance, net | **–0.5** | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.3 | 0.1 | |
| | D) Commercial borrowings, net | **–0.5** | 0.7 | 0.3 | 1.8 | 0.6 | 0.2 | 0.7 | 0.5 | |
| 5 | **Overall balance** | **5.1** | **3.6** | **1.8** | **7.4** | **–1.7** | **1.0** | **0.8** | **–0.8** | **-0.5** |

Source: Reserve Bank of India

* Author's projection

# Central Government Fiscal Indicators (As % of GDP)

| | 2003/4-2007/8 | 2007/8 | 2008/9 | 2009/10 | 20010/11 | 2011/12 |
|---|---|---|---|---|---|---|
| **Total Revenue Receipts** | **9.9** | **10.9** | **9.6** | **8.9** | **10.3** | **8.7** |
| a) Tax Revenue (net) | 7.6 | 8.8 | 7.9 | 7.1 | 7.4 | 7.3 |
| b) Non-tax Revenue | 2.3 | 2.1 | 1.7 | 1.8 | 2.9 | 1.4 |
| **Total Expenditure** | **14.8** | **14.3** | **15.7** | **15.9** | **15.6** | **14.9** |
| a) Revenue Expenditure | 12.2 | 11.9 | 14.1 | 14.1 | 13.6 | 13.1 |
| of which: Subsidies | (1.4) | (1.4) | (2.3) | (2.2) | (2.3) | (2.4) |
| b) Capital Expenditure | 2.6 | 2.4 | 1.6 | 1.7 | 2.0 | 1.8 |
| **Revenue Deficit** | **2.3** | **1.1** | **4.5** | **5.2** | **3.3** | **4.5** |
| **Gross Fiscal Deficit** | **3.6** | **2.5** | **6.0** | **6.5** | **4.9** | **5.9** |
| **Primary Deficit** | **-0.2** | **-0.9** | **2.6** | **3.2** | **1.8** | **2.8** |

**Sources: CSO and Reserve Bank of India.**

# Budget Priorities

* Keep Fiscal Deficit at 4.8% of GDP or lower, by:
  - Keep tight rein on expenditures
  - Persevere with "creeping liberalization of diesel prices"
  - Increase Urea issue prices (?)
  - Postpone, effectively, Food Security Bill passage.
  - Raise personal income tax rate for income bracket above Rs.15 (or 20) lakhs by 3-5 per cent points (that is, to 33 – 35%). Best done via surcharge.
  - Increase numerous concessional rates in Excise towards modal CENVAT rate (12% at present).
  - Consider raising general rate for Excise and Services tax from current 12% by 1 – 2 percent points.
* DO NO HARM
* Reforms ?

# Policy Priorities: Near Term

A) Reduce growing fiscal deficit:

- Increase POL and fertilizer prices
- Slowdown on entitlement programmes

B) Resurrect Reform Thrust:

- Implement FDI in Retail and other sectors.
- Fast-track Goods and Services Tax (GST)
- Push pending laws on insurance, banking and pensions.

C) Restore Investor Confidence:

- Reverse bad tax measures of 2012 Budget.
- Unblock logjam in major infrastructure sectors such as power, coal, roads, telecom, etc.

D) Improve Exchange Rate Management

# Policy Priorities : Medium Term

- Revamp of energy sector policies.
- Reform of Land, Water and Natural Resource allocation systems.
- More flexible labour laws and better skill development to realize demographic dividend.
- Meeting challenge of Urbanization.

# Thank You