Current Economic Prospects and Challenges for India

by

Shankar Acharya *

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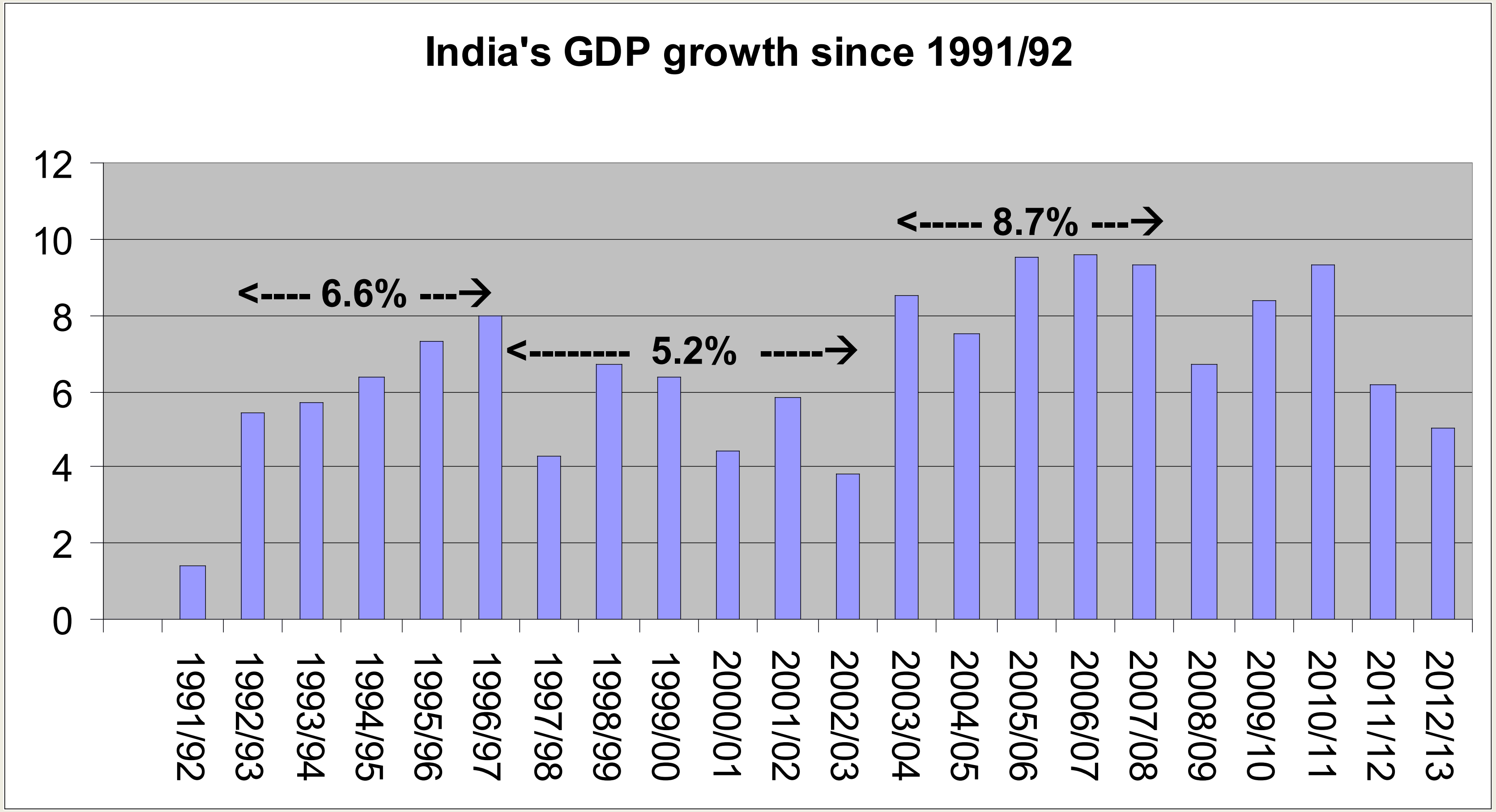
* Honorary Professor, ICRIER (former Chief Economic Adviser to the Government of India, 1993-2001)


India's GDP growth since 1991/92
12
10
8
6
4
2
0
<---- 6.6% --->
<-------- 5.2% ----->
<----- 8.7% --->
1991/92
1992/93
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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
World output[a]	**3.8**	**1.6**	**–2.1**	**4.2**
Advanced economies	**2.8**	**0.2**	**–3.4**	**3.2**
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
Emerging-market and developing economies	**8.1**	**6.1**	**2.8**	**7.5**
Russia	7.7	5.2	–7.8	4.3
China	12.7	9.6	9.2	10.4
India[b]	**9.5**	**6.7**	**8.4**	**9.3**
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.

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 (6th 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 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**			
<u>Sectors</u>							
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

Source: Reserve Bank of India, Handbook of Statistics on the Indian Economy, 2011-12

Note : Industry excludes "Construction", which is included in "Services".

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, land allocation, and Telecom.

Crises Building in 2012 Summer

1) External liquidity (BoP) crisis.
2) Crisis in energy/ infrastructure sectors.
3) Prospect of slow (5 – 6%) growth for several years.
4) Bleak outlook on medium-term employment prospects for India’s “youth bulge”; OR “demographic dividend” could became a nightmare.
5) 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
2	Invisibles, net	4.5	4.3	5.0	6.1	7.5	5.9	5.1	6.1	6.0
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	5.0
5	Overall balance	5.1	3.6	1.8	7.4	–1.7	1.0	0.8	–0.8	0.0

Source: Reserve Bank of India
* Author’s projection

India's Key External Debt Indicators (Per cent)

Year	External Debt (US$ billion)	Debt Service Ratio %	Foreign Exchange Reserves to Total Debt %	Short-Term External Debt to Foreign Exchange Reserves %
	(1)	(2)	(3)	(4)
2007-08	224.4	4.8	138.0	14.8
2008-09	224.5	4.4	112.1	17.2
2009-10	260.9	5.8	106.8	18.8
2010-11	305.4	4.3	99.6	21.3
2011-12	345.4	6.0	85.2	26.6
End Sept 2012	365.3	-	80.7	28.7

Source : Ministry of Finance

Central Government Fiscal Indicators (As % of GDP)

	2003/4-2007/8	2007/8	2008/9	2009/10	20010/11	2011/12	2012/13 (RE)	2013/14 (BE)
Total Revenue Receipts	**9.9**	**10.9**	**9.6**	**8.9**	**10.3**	**8.7**	**8.7**	**9.3**
a) Tax Revenue (net)	7.6	8.8	7.9	7.1	7.4	7.3	7.4	7.8
b) Non-tax Revenue	2.3	2.1	1.7	1.8	2.9	1.4	1.3	1.5
Total Expenditure	**14.8**	**14.3**	**15.7**	**15.9**	**15.6**	**14.9**	**14.3**	**14.7**
a) Revenue Expenditure	12.2	11.9	14.1	14.1	13.6	13.1	12.6	12.7
of which: Subsidies	(1.4)	(1.4)	(2.3)	(2.2)	(2.3)	(2.4)	(2.6)	2.0
b) Capital Expenditure	2.6	2.4	1.6	1.7	2.0	1.8	1.7	2.0
Revenue Deficit	**2.3**	**1.1**	**4.5**	**5.2**	**3.3**	**4.5**	**3.9**	**3.3**
Gross Fiscal Deficit	**3.6**	**2.5**	**6.0**	**6.5**	**4.9**	**5.9**	**5.2**	**4.8**
Primary Deficit	**-0.2**	**-0.9**	**2.6**	**3.2**	**1.8**	**2.8**	**2.0**	**1.5**

Sources: CSO and Reserve Bank of India.

Budget 2013/14: Hits and Misses

- Delivers on FM's promise to target Fiscal Deficit at 4.8% of GDP. (But note this is double of level in 2007/8). Will it be enough (if achieved)?
- Revenue deficit is targeted to decline to from 3.9% of GDP to 3.3%. This is **thrice** the level in 2007/8.
- Decline in Government Dis-savings (revenue deficit) by 0.6% of GDP, even if achieved, is not enough against background of CAD of 5% of GDP and equivalent Investment-Savings gap.
- Commitment to National Food Security Bill passage amplifies long-term problem of "Entitlement" expenditure growth and subsidy containment.
- Budget numbers of FY 14 look a little optimistic in regard to **tax revenue, disinvestments, telecom auction proceeds** and **subsidies.**

Prospects for FY 2014

• GROWTH (GDP@ factor cost)	Less than 6%
• INFLATION (GDP Deflator)	7- 8%
• FISCAL DEFICIT (Centre; % of GDP)	5.0%
• CURRENT ACCOUNT DEFICIT (% of GDP)	4 –5 %
• GROSS FIXED INVESTMENT (% of GDP)	28-30%
• GROSS DOMESTIC SAVINGS (% of GDP)	28-30%
• EMPLOYMENT	NOT GOOD
• POVERTY REDUCTION	SLOW
• CHANCE OF BoP CRISIS	Above 50%

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