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L'Inde : vision de la crise européenne et impact sur l'économie indienne / *IA perspective from India on the Eurozone Crisis*

Sous la présidence de CHRISTOPHE DESTAIS
Directeur adjoint, CEPII ; Administrateur-délégué, Club du CEPII

INTERVENANT

SAUMITRA CHAUDHURI
Member of the Planning Commission & Member of the Economic Advisory Council to Prime Minister

DISCUTANT

EDGARDO TORIJA-ZANE
Economiste, Asie émergente, Département de la Recherche économique, Natixis

Compte rendu rédigé par
Claire Labonne, Etudiante à l'ENSAE et à PSE

(27 slides in annex)

A Perspective from India on the Eurozone Crisis

India, Global crisis & our Plan for the Future

In 2008, the impact of the global crisis on the Indian economy was significant. Three channels of propagation can be identified: external trade in goods and services, investment financing and business confidence. The real value of traded goods went down. Investment is very sensitive in India because of particular features of risk aversion in emerging countries. Constant businessman travels make the Keynesian issue of business confidence key, since completely integrated.

Alteration in both investment financing and business confidence prevented a recovery in the pace of investment as sharp as the output growth one. A lot of difficulties we created ourselves but high inflation (partly due to high world commodity prices), poor global investment climate and risk aversion are not helpful in the recovery of the pace of domestic investment.

The very sharp recovery in quarterly GDP growth rates we can observe from Q4-2008-09 to Q4-2009-10 was nonetheless followed by weakness in the pace of growth. Looking at quarterly investment growth rates has not recovered but rather continued to slow down. This is particularly notable in fixed investment. The Indian government wants to bring back investment to 30%-32%.

With regards to fiscal consolidation, the beginning of a solvency crisis developed in the 2000s. The fiscal situation started to weaken in the late 1990s. Despite the increase in deficits due to the crisis, economy, tax rates and tax bases growth allowed for significant consolidation. The debt ratio decreased from 80% in the 2000s to 65% in 2011 thanks to real economic growth.

India faces an important inflation problem to be solved before focusing on other economic issues. In 2010, primary food went to the roof while average Indian budget coefficient for food is quite high. Money wages raised and inflation was thus passed to manufactured goods.

We recognize the difficult international economic and financial context but still consider shooting for 9% GDP growth in the 12th Five Year Plan (2012-2017) reasonable. Indeed, adequate sources of demand and productivity growth within the Indian economy combined with prudent macroeconomic balances can spur rapid growth. Furthermore, focusing on trade, financial and economic integration with our neighbors – Asia & Africa would provide additional sources of development.

Detailed goals are:

- Modest increase in the fixed investment rate by 4 percentage points of GDP from current levels
- Domestic savings rate to go up by a similar order, mostly through fiscal consolidation
- Limiting current account deficit to 2.5% of GDP and coming down slightly in closing years
- Inbound net foreign equity flows averaging 2.5% of GDP
- Headline inflation of 5% with primary food & energy higher and other items, included manufactured goods at a lower level

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Uncertainty, risk aversion, high volatility are working against growth promoting under-utilization of capital and opportunity, as exemplified by the Sub-Saharan Africa economies. India would for sure like to see some of the uncertainty reduced so consider any improvement in the Eurozone a positive development.

Crises in the Eurozone

The past 30 years has seen economic integration on a more equal basis than ever before. Better economic policies that emphasized fiscal and monetary stability as well as competition and market access rejuvenated western economies from the economic and social crises of the late 1960s and 1970s. Lowering trade barriers generated unprecedented gains for developing economies and lifted apprehensions about western “neo-colonial” intentions. The last three decades also gave south-south trade the self-confidence it needed.

From our point of view, the crisis in the Eurozone is perplexing and vexing. Even though comparison may not be exactly accurate, it reminds us of our own situation about our old economic policies of production and price controls. It took us a lot of time to realize we only developed black markets and even more time to get rid of all these damaging structures. The European currency union has yoked 17 horses of very different caliber to the same carriage and is surprised that results are unfortunate.

European convergence is absolutely not obvious. Divergences are so marked understanding and visualizing a global solution is very hard. Between 1980 and 2007, apparent convergence came only at the price of lower growth rates in Greece and Spain. Divergence of inflation appears much lower but we can note problematic countries had sustained higher inflation. Looking at domestic savings as percent of GDP show they have clearly weakened in affected economies and worsened in recent years. Concerning current account deficits, they got very weak in affected countries, in the run-up to the Euro and thereafter. Finally, fiscal deficit, before and after entry in the Eurozone was south of average for peripheric countries (except Ireland and Italy).

So I want to ask a simple question: is it a 2-track system? It appears clearly Greece, Portugal and Spain have their own track – with Greece more of an outlier. Ireland is different: doing well on most counts, the country made a mistake guaranteeing not only bank deposits but bank liabilities. Italy suffers from slower growth but macroeconomic indicators do not show excesses. The governance is to be taken into account.

We have to consider the effect of the fixed exchange rate, computing the implied PPP conversion rate to the dollar relative to 2000. For Germany or France, competitiveness improved whereas all peripheral countries went out of track. In India and China, not correcting the exchange rate would have hampered growth recovery and the poverty reduction that stemmed from.

The future trajectory of concerned economies must be sustainable for the crisis to be solved. To face a conventional balance of payment problem combined with a fiscal and bank problem, one should use the Asian currency crisis example. The imbalances that are most in evidence don’t get addressed other than by large scale re-pricing in which exchange rate correction provides the way.

Europe should correct for accumulated erosion of competitiveness to allow growth. Growth only would make fiscal correction likely. If no exchange rate correction takes place, devaluation could only be internal, i.e. wage earners would take the adjustment burden. Social tensions likely to rise will create even more instability. In elective systems with already weak credibility, unpopular decisions are hard to carry through, especially over such a protracted period.

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India has full sympathy for the efforts undertaken and early resolution of the crisis is in all of our collective interests. However, it is hard for us to be persuaded that the problem is being resolved in a comprehensive manner. The accumulation of unresolved issues is becoming even more dangerous. Unintended consequences and resultant contagion have a large negative potential that is perhaps being missed in the heat of the moment.

EDGARDO TORIJA-ZANE

Apart from the external risks highlighted in the presentation, I would like to underline two internal risks for macroeconomic performance.

Firstly, since services are growing faster than the rest of the economy, especially manufactured goods and agriculture, incomes in urban areas growth fast, some people get richer so consume more, which spurs inflation as the elasticity of supply of food items remains low. Inflation is structural, inexorably linked to the way India grows, and not only a matter of policy mix. The solution for inflation comes from public investments and policies increasing infrastructure-investment profitability. If we look at the 11th Five-year Plan results, we can see a lot of progress but also a long way ahead

Second, the concentration of wealth in cities arise the threat of a two-speed growth. The government fights inequalities through an increase in subsidies and setting social programs like the NREGA. Of course, the increase in subsidies and social policies contribute to the fiscal deficit but it suggests fiscal unbalances are not only an issue of lack of discipline. Again, the current growth regime generates unbalances, at fiscal side but also external, as services net export surplus do not offset good imports growth. With respect to the fiscal issue, is not the government spending too few rather than too much? In India, consolidated government expenses represent 25% of GDP when French expenses amount to 56%, Brazil 39%, Great Britain 45% and the United States 41%.

Exports behave quite well in 2011 and a 2.5% deficit in current account balance seems indeed manageable although the dependence on external financing could generate troubles in the current global environment. The rupee depreciation in September (-10% versus the dollar) is a sing of it. Volatility in the foreign exchange rate could by the way complicate the RBI's task, as monetary policy is already pursuing two different objectives, price stability and a cheap financing for the fiscal deficit in the domestic market.

About the second part, I mainly agree. My intuition is that Europe need to recreate most Eurozone institutions if the will is to keep a common currency. Convergence rules are to be replaced by real convergence through the adoption of common taxation schemes for example and other forms of federalism.

Let's think about East Germany integration: the country suffered from deficits and an outdated industry but shared a common budget that allowed rapid convergence with the West.

DEBATE

Sanyal Bikas C., Maison de l'Inde: Opening economies was indeed profitable but who really benefited from it? How did bank exploit the situation? We are in front of the problem of the unaccountability of financial institutions.

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S. Chaudhuri: How can we create equal opportunity? In 2004, we created a program to expand connectivity through road access and equipments. Lately, growth improved enormously. Inflation is not only a matter of interest rates in a country with a poor distribution network.

We should not forget the US mortgage crisis is rooted in the political desire that every American should own a house. Its origins are to be found in bad regulation, not deregulation.

Christophe Hemery, Ernst & Young: What about Moody's decision to downgrade Indian banks? What to expect concerning the direction of Indian investment flows?

S. Chaudhuri: Indian banks balance sheets are stressed by long-term infrastructure projects. But we should also remember a rating rule states that any entity rating cannot exceed sovereign rating.

As for investment, Indian companies are very active investors. Places depend on the business nature. Net FDI is very small. We should make India more attractive.

Mandrekar Nikhil, OECD: How to use innovation policies to raise new sources of growth? How successful could this be in India?

S. Chaudhuri: According to my experience, it does not work very well. You can provide assistance once but any project should be sustainable on its own.

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