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LEAD

Hope with concerns in 2019

C. Rangarajan

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Five issues need to be addressed comprehensively if India is to achieve sustained high growth

The New Year is always looked forward to with hope, whatever the conditions might have been the previous year; 2018 has been a mixed bag, both globally and domestically.

Globally, the growth rate in 2018 was high, particularly in the United States. But strong signs of a trade war emerged, dimming hopes of faster international trade. Britain is passing through the pangs of separation from the European Union. Domestically, the first quarter growth rate was high. But signs are not good for the balance of the year. The rupee underwent a severe shock as crude oil prices rose, and abated after a fall in oil prices. While prices fell, agrarian distress accentuated.

India's growth rate in 2018-19 is forecast at 7.4% by the Reserve Bank of India (RBI). But it looks to be a touch-and-go situation. More likely, it will be slightly lower. Looking ahead, 2019 may not show any substantial rise in the growth rate. Even though the Goods and Services Tax (GST) has stabilised, much will depend on the pickup in the investment rate.

The international environment is not that conducive for growth in our foreign trade; this will have an impact on our exports and, therefore, growth. Perhaps the growth rate will be between 7.2% and 7.5%. Though this may be the highest growth rate of any country, it falls short of our requirements.

Going ahead, what are our major concerns?

Investment ratio

In the final analysis, the growth rate depends on the investment rate and the productivity of capital or its inverse incremental capital-output ratio.

The incremental capital output ratio is a catch-all expression. It depends upon a multiple number of factors such as quality of labour, which again depends on education and skill development levels, and technology, which is constantly changing. For ensuring a sustained high growth, we need to raise the investment ratio and keep the incremental capital-output ratio at 4. The Gross Fixed Capital Formation ratio has fallen from 35.8% in 2007-08 to 28.5% in 2017-18. The journey to raise the investment ratio is not going to be easy. 'Animal spirits' must be revived. A tranquil political and economic environment needs to be nurtured.

Banking system

An important factor affecting economic growth is the condition of our banking system. Non-performing assets (NPAs), including stressed assets, as a proportion of **loans** of public sector banks stood at 16.7% as of March 2018. As many as 11 public sector banks are under Prompt Corrective Action (PCA). This restricts the lending abilities of these banks. Added to this, the non banking financial company (NBFC) system is also under stress. This is partly a reflection of the stress in the banking system since most NBFCs borrow from banks. Recapitalisation of public sector banks will partly solve the problem. It is not clear at this point how much it will help in adding to lending capacity.

Some have advocated providing more capital to banks outside the PCA framework as that will increase their lending capacity immediately.

Today, banks are responsible both for short-term and long-term lending. Their inability to lend affects the availability of working capital as well as capital expenditures.

The decision to pump in more capital to public sector banks must be completed soon. The growth rate in the industrial sector will depend on how quickly the **banking** system comes back to normalcy.

Employment growth

There is a great concern about the inadequate growth of employment. Honestly, we do not have satisfactory employment numbers. The employment data in the organised sector are reliable. But the employment in the informal sector is much larger. One question that is asked is that if growth is around 7%, why is there no corresponding growth in employment? We need to keep two factors in mind. Growth can occur either as a result of increase in investment or because of better utilisation of existing capacity. It is growth which is led by new investment that leads to a significant increase in employment. But growth caused by improved efficiency of utilisation of existing capital can lead only to a marginal increase in employment. Much of the growth seen in the last few years is of the latter variety.

Second, the increase in employment seen in the period between 2004-05 and 2009-10 was because of the rapid growth of the information technology (IT) and financial sectors. The IT sector has slowed down. The financial sector is under stress. Employment in these sectors was visible and educated entrants into the labour market found ample opportunities. The IT sector growth rate is not likely to pick up significantly as this industry is undergoing many structural changes. The revival of the banking system depends on a number of factors. Thus, even from the point of view of employment, the key factor is the pickup in investment.

India's external sector has grown and is well integrated with the rest of the world. India's trade in goods and services as a percentage of GDP has grown to 42% of GDP. Therefore, what happens in the rest of the world affects India's growth very much. India's balance of payment situation has been comfortable since liberalisation. However, there are vulnerabilities as seen in September-October 2018, when the value of the rupee suddenly plummeted when crude oil prices rose and there were simultaneously capital outflows. RBI intervention and the subsequent fall in crude prices have restored the value of the rupee. In April-November 2018, India's exports of goods grew by 11.6%. However, we need to note that exports growth was 5.2% (2016-17) and 9.8% (2017-18). Strong growth in exports is a must if we have to keep the current account deficit (CAD) at a manageable level.

The forecast for world trade and output is not encouraging. There are too many uncertainties which include an intensification in the trade war. Along with export promotion, we also need to contain some of our large imports. A watch on India's CAD is critically important if we have to achieve growth with stability.

Agrarian distress

The future growth also depends on the performance of **agriculture.** Agrarian distress is widespread. Strangely, the fall in prices of agricultural products is in one sense a reflection of our success in raising output. Some years ago, the concern was a rise in the price of pulses to abnormally high levels. But today the picture is reversed. Thanks to increase in production, prices have fallen. Similar is the case with respect to vegetables, particularly onion. The need of agriculturists is income in current prices. The solution to the fall in prices lies in government intervening in the market and buying off the surplus over normal levels. The market will then automatically take prices to the normal level. The important requirement in this context is not only the financial capacity of the government to procure but also adequate physical arrangements to procure and store. The procured agricultural products can be sold by the government in later years when output is low or utilised in any safety net programme.

Loan waivers are at best short-term solutions. The fundamental problem is one of increasing productivity and enabling farmers to achieve increased output and better prices. There is also a basic weakness that we have to address. The average size of landholding is so small that any amount of increase in productivity will not give adequate income. Farmers have to think in terms of consolidation of landholdings so that they can get the benefits of larger size. Small farmers will also have to think in terms of higher value-added products like vegetables. A combined attack to increase productivity, consolidate landholdings and improve marketing is needed to assure farmers of better income.

Thus there are five concerns as we stand at the beginning of 2019. These are: raising the investment ratio; putting the banking system back on the rails; employment generation through better growth; enhancing export growth to contain the CAD; and removing agrarian distress by increasing productivity and consolidation of small landholdings. These issues need to be addressed comprehensively, if we have to achieve sustained high growth.

C. Rangarajan is Former Chairman of the Economic Advisory Council to the Prime Minister and Former Governor, Reserve Bank of India