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# The twist in the growth story

C. Rangarajan

The data on national income released recently give a new twist to India's growth story. The most significant change is with respect to the growth rate for 2013-14. While the earlier estimate showed a growth rate of 4.7 per cent, the growth rate according to the new estimate is 6.6 per cent. Much of the pessimism seen in the Indian economy during 2013-14 is not vindicated by the new data. While the investment rate did show a sharp decline during the last three years, a greater part of it was due to the decline in the investment rate of households rather than the corporate sector. Thus, the slowdown in the economy was not as severe or extended as was feared earlier. Nevertheless, it is useful to review the developments so that the errors can be corrected and the country can move on to the high growth path.

## Slowdown and its causes

Under the impact of the financial crisis, the Indian economy registered a growth of 6.7 per cent in 2008-09, after having posted a growth rate exceeding 9 per cent for three consecutive years. The recovery from the impact of the global crisis was however swift and sharp. The economy achieved a growth rate of 8.6 per cent in 2009-10, despite a severe drought. The growth rate rose further to 8.9 per cent in 2010-11. Then the decline began. In 2012-13, the growth rate came down to 4.5 per cent according to the old estimate and 4.9 per cent as per the new estimate. In 2013-14 the growth rate was 4.7 per cent and 6.6 per cent according to old and new estimates respectively.

The slowdown has been attributed to supply side bottlenecks, price shocks and weak investment demand. Agricultural output declined in

2009-10. Coal output fell and the output of iron ore also fell, partly because of certain court decisions. International commodity prices, particularly that of oil remained high, despite the poor performance of the advanced economies. The investment sentiment was affected by various factors including non-economic. Perhaps one policy action which affected investors was the decision to apply certain tax laws with retrospective effect. The stability of the tax system became a cause of concern. Moreover, many good decisions of the government were either delayed or postponed. The energies of the government were also absorbed in dealing with issues such as graft. All these created an element of uncertainty in the minds of investors.

However, recent data do not show a decline in corporate investment rate. While earlier data showed the Corporate Gross Fixed Capital Formation rate going down to 8.5 per cent in 2012-13, the new data show the rate at 11.8 per cent in 2012-13 and 11.4 per cent in 2013-14. However there is some evidence that new projects slowed down. According to a study done by the Reserve Bank of India, the total project cost of new investments in 2011-12, 2012-13 and 2013-14 were Rs.2,120 billion, Rs.1,963 billion and Rs.1,340 billion respectively. Contrast this with new investments of Rs.5,560 billion in 2009-10.

## Short and medium-term solutions

The fact that stands out is that the decline in the output growth was much stronger than the decline in investment. The investment rate in 2007-08 was 38.1 per cent of GDP. By 2013-14, it had come down to 32.3 per cent, even according to revised estimates. With the incremental capital output ratio of 4, which has been normal for almost a decade even, this lower investment rate should have given us a growth rate of 8 per cent. But the actual growth rate turned out to be less. The rise in the incremental capital output ratio could have been either because projects were not completed in time or because complementary investments were not forthcoming. In some cases, this could also be due to non-availability of critical inputs such as coal and power. This then points to the fact that, in the short run, speedy completion of projects by itself can raise the growth rate. In the medium term, we however need to ensure that the investment rate goes up and the productivity of capital remains high. Only then can the country get back to the high growth rate path.

Speedy completion of projects requires attention at the micro and at the policy levels. While every effort should be made to remove administrative bottlenecks, issues relating to the environment and land acquisition also need attention. The concerns relating to environment and land acquisition are genuine. They cannot be wished away. We need to work out an acceptable compromise between the compulsions of growth and the concerns relating to environment and land acquisition. A process of consensus building needs to be initiated.

Sustained high growth requires macroeconomic stability which has three dimensions — low inflation, low current account deficit and modest fiscal deficit. In one sense, all the three are interrelated. We have had difficulties on all these fronts in recent years. The moderation in inflation has occurred only recently. The Current Account Deficit has again come under control. We will be the beneficiaries of the fall in oil prices. The fiscal deficit continues to remain above the level mandated in the Fiscal Responsibility and Budget Management (FRMB) Act. The commitment to bring down the fiscal deficit must be honoured. It is in this context that subsidies require a relook. The subsidy regime needs reform in three directions. First, there has to be a fix on the total quantum of subsidies as a proportion of GDP, second, they need to be targeted and only directed towards vulnerable groups and, third, there has to be a rethink on the appropriate delivery system. Government's expenditures need to be reoriented more towards investments and less towards subsidies.

**'Make in India'**

Going ahead, "Make in India" is a good guiding principle. It should imply producing for India and for the world. Making only for India will convert it into a form of import substitution. Making for the world makes the system more efficient. On the other hand, people wonder whether making for the world is even meaningful in the changed world context. It is true that extreme dependence on the external world can cause serious repercussions on the domestic economy, when the world environment suddenly changes, as in 2008 and 2009. India however is not in any such danger. India's exports as a percentage of GDP is still modest at 25 per cent. Besides, India's exports of goods do not constitute more than 2 per cent of the world's exports. In this situation, making India the base for the production of goods and services for export to other countries is not a bad idea. But to convert this idea into reality, the Indian economy has to be much stronger in terms of infrastructure and the availability of good human capital. Productivity of capital must increase which implies a more efficient system of production.

## Reform agenda

Reforms must be part of a continuing agenda. The basic principle guiding reforms must be to create a competitive environment with a stress on efficiency. There are still several segments where controls dominate. A classic example is the sugar industry. We need to dismantle controls in a phased manner. The pricing of products should normally be done by markets. Exceptions should be made transparent and must be clearly articulated.

In many ways the coming decade will be crucial for India. If India grows at 8 to 9 per cent per annum, it is estimated that per capita GDP will increase from the current level of $1,600 to $ 8,000-10,000 by 2025. Then, India will transit from being a low income to a middle income country. We need to overcome the low growth phase as quickly as possible. In the recent period, a number of schemes have been launched aimed at broadening the scope of social safety nets. These include the employment guarantee scheme, universalisation of education, expansion of rural health, and providing food security. It has been possible to fund these programmes only because of the strong growth that we have seen in recent years. Growth is and must be the answer to many of our socio-economic problems.

*(Dr. C. Rangarajan is former Chairman of the Economic Advisory Council to the Prime Minister.)*

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