Economic Growth:
Concerns & Challenges

by **C Rangarajan**

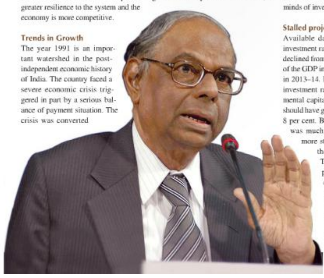
An 8–9 per cent annual growth rate can push up our per capita GDP from the current US $1,600 to US $8,000–10,000 by 2025.

The Indian economy is currently passing through a phase of relatively low growth. We need to examine the reasons for this slowdown so that we can correct the errors and move forward to a higher growth path. This however should not cloud the fact that over the decade beginning 2004–05, the average annual rate of growth of the economy has been 7.7 per cent. We should not also underestimate the structural changes that have occurred in the Indian economy over the last two decades. These have imparted greater resilience to the system and the economy is more competitive.

Trends in Growth

The year 1991 is an important watershed in the post-independent economic history of India. The country faced a severe economic crisis triggered in part by a serious balance of payment situation. The crisis was converted into an opportunity to bring about some fundamental changes in the content and approach of economic policy. That our economic reforms have been in the right direction is vindicated by the improved performance of the economy since the launch of reforms. Further, between 2005–06 and 2007–08, the Indian economy grew at an average rate exceeding 9.5 per cent. However, under the severe impact of global crisis, our economy declined sharply in 2008–09. But, the recovery was swift and sharp. In the next two years, the economy grew close to 9 per cent. In 2011–12, it came down to 6.7 per cent and declined further to 4.5 per cent in 2012–13. In 2013–14, according to earlier estimates, the growth rate was 4.7 per cent but according to the revised methodology, it is estimated at 6.8 per cent.

There are a number of factors both economic and non-economic which have contributed to the recent decline in growth rate. These include supply side bottlenecks, price shocks and weak investment demand. The investment sentiment was affected by various factors, political and economic, and this created an element of uncertainty in the minds of investors.



Stalled projects

Available data show that the gross investment rate of the Indian economy declined from the peak of 38.1 per cent of the GDP in 2007–08 to 32.3 per cent in 2013–14. Even with this decline in investment rate, with a normal incremental capital-output ratio of 4:1, we should have got a growth rate of around 8 per cent. But the actual growth rate was much lower, declining much more steeply than warranted by the decline in investment. This may be because projects have not been completed in time or complementary investments have not been forthcoming. In some cases, this can also be due to non-availability of critical inputs such as power.

The Economic Survey has examined in detail the causes behind 'stalled' projects. The reasons include not only delay in clearances and permits but also decline in demand and lack of finance. The analysis also shows that clearing the top 100 projects by value will address 83 per cent of the problem of 'stalled' projects. Thus the easiest way to achieve higher growth in the short run is to ensure that ongoing projects are completed in time so that output will flow out of it. However, a return to the high growth regime of 9 per cent plus will require the investment rate to rise, along with an improvement in the productivity of capital.

When private investment sentiment is weak, public investment has to play the catalytic role. Some of the key infrastructure segments such as coal, roads, railways and power lie largely in the public domain. Achieving the production and capacity creation targets in these public sector enterprises could act not only as a driver of growth but also crowd in the private sector. What can inspire confidence is a clear statement from the government regarding the quantum of investment that will be made by the various public sector entities. This should be monitored every quarter and the capital investments made should be made public. Besides making the government accountable, this will inspire confidence in the minds of investors.

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Stability

For sustained high growth, stability is a prerequisite. And stability in this context has three dimensions — first, price stability, next, low current account deficit and third, modest fiscal deficit. After some years of disturbing trends, we have now achieved a measure of stability in prices. Inflation remains below five per cent. We must continue to maintain it at this level. The current account balance will benefit as a consequence of the decline in crude oil prices. Price stability will help to maintain the competitiveness of Indian exports. While financing the current account deficit may not be a problem, it is best to contain the current account deficit over the medium term below 2 per cent. As regards fiscal deficit, the central government needs to move as quickly as possible towards the level mandated by FRBM Act which is 3 per cent of GDP.

Medium Term Challenges

Over the medium term, many issues need to be tackled. A reference was made earlier to the need to raise the savings and investment rate and improve the productivity of capital. Sectorally, the two key areas that would need focused attention are agriculture and infrastructure. Even though agriculture contributes only 15 per cent to GDP, it still plays a crucial role. Any shortfall in agricultural production fuels inflation and the human distress is high as more than 50 per cent of the people depend on agriculture. The size of the average landholding is getting smaller and smaller and how to make such marginal holdings efficient and more productive is a critical issue that needs to be addressed.

There has been considerable discussion on improving the infrastructure in the country. Infrastructure growth will facilitate growth of other sectors. Transport and power sectors need focused attention. Policy framework should be such as to encourage the flow of investment into these sectors and this should be accompanied by efficient project level management. Our total infrastructure needs are large. Domestic investment will have to be supplemented by foreign investment.

Conclusion

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 US $1,600 to US $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, as growth is the answer to many of our socio-economic problems. In the recent period, we have launched a number of schemes aimed at broadening the base of growth. These include the employment guarantee scheme, universalisation of education, expansion of rural health, and providing food security. All these programmes have made a substantial demand on public expenditure. It has been possible to fund these programmes only because of the strong growth that we had seen earlier. Growth had facilitated raising more resources by the Government.

Development has many dimensions. It has to be inclusive, it must be poverty reducing, and it must be environment-friendly. We need to incorporate all these elements in the growth process. A strong and balanced growth will enable the economy to achieve multiple goals including reduction in poverty.

(The writer is a distinguished economist and former RBI Governor.)