Improve the investment climate

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India's growth performance in 2015 has fallen short of our expectations and needs. A strong recovery is possible in 2016 with growth rate exceeding 7.5 per cent but that is contingent on private investment showing substantial improvement

The year 2015 has ended on a lacklustre note. The growth rate projected by the International Monetary Fund (IMF) is 3.1 per cent, with advanced economies growing at around 2 per cent and developing economies at 4 per cent. These are not inspiring numbers. The World Bank estimates are even lower. However, there have thankfully not been any economic explosions.

Even Europe stumbled through despite the problem of Greece rearing its head from time to time. The oil-exporting countries suffered most with a sharp decline in oil prices. This group included not only countries in West Asia but also Russia and Venezuela.

However, what is more surprising is that even countries which had gained as a consequence of a fall in crude oil prices have not really shown faster growth. Among the developing economies, the major concerns are centred at China. With trade surpluses falling, China has to turn to its domestic demand to spur the economy. There have also been concerns about its financial system.

A dismal picture

Among the countries coming under the Brazil, Russia, India, China, South Africa (BRICS) bloc, only India has shown a good performance. However, the Indian story needs more elaboration. Before dealing with India, let us see what the picture looks like globally for 2016.

The IMF had projected the global growth rate for 2016 to be 3.6 per cent, with advanced economies growing at 2.2 per cent and developing economies growing at 4.5 per cent. At this point, it is not clear whether these projections will hold. A recently released World Bank report shows lower numbers for both 2015 and 2016. However, the direction of change is similar.

Among the advanced economies, one country that may show an improved performance is the United States. The recent decision to hike the policy rate by the Fed is some indication that monetary policymakers believe that the U.S. economy is on a recovery path. It is, however, to be remembered that the Fed has not yet relaxed its accommodative posture, which indicates that the recovery is fragile. Oil prices are not expected to rise, which means that oil-producing countries will continue to be in a limbo. Among the developing economies, concerns about the performance of China will continue. If anything, China's growth rate will further decline.

While the improved performance of the U.S. is a helpful factor, the rise in interest rate may have its own effects on capital flows to developing economies. As a consequence, financial markets may see greater volatility. Thus, the picture, as a whole, does not look very encouraging. Only a few countries are likely to show better performance. Luckily, India can be one among them, but some important steps need to be taken.

The mid-year economic analysis estimates India's growth rate in 2015-16 to be between 7 and 7.5 per cent. This is a fair assessment. Looking at the performance from the supply side, in agriculture, the growth rate may not be higher than the previous year which itself was low. The erratic weather in 2015 does not hold out much promise for 2015-16.

> The ability of the government to raise money for capital expenditures will be limited. However, relaxing the fiscal consolidation path is not a solution

In the services sector, the growth rate may not be much different from that of the previous year. The only possibility of improvement is in the industrial sector. The Index of Industrial Production (IIP) for April-October 2015 shows a distinct improvement over the corresponding period of the previous year. Looking at the problem from the demand side, external demand, as reflected in the performance of exports, has been weak. Overall, exports during the period of April-October declined by 17.6 per cent. Much of this is due to the decline in the export of petroleum products, by more than 50 per cent. However, non-oil exports also declined by 8.7 per cent during this period. This does not auger well for many industries.

Private consumption could pick up partly because of the benefit accruing to consumers due to the fall in petroleum prices. The consumption goods sector of IIP has done well. Public sector investment has shown a rise. Capital expenditure of the Central government during the period April-October 2015 rose by 31 per cent. However, it must be noted that bulk of the public investment came from the public sector enterprises.

Public investment alone inadequate

The Achilles heel here is private corporate investment. All surveys point to continued stagnation in this area. Thus, from the demand side, the only redeeming feature is the rise in public investment. But that by itself will not be adequate to pull the economy strongly forward. Thus, the overall assessment is that the growth rate in 2015-16 may not be higher than that in the previous year.

What about the Financial Year of 2016-17? Are there signs which point to a faster growth? The external environment, as already noted, will not be encouraging. India's exports will face a challenging task in 2016. There is an imperative need to reverse the current negative trend.

In 2015-16, one favourable factor operating on growth has been public sector investment. Despite a lower-than-expected growth in nominal GDP, revenue growth has remained close to the budgetary expectations. On the expenditure side, the subsidy burden came down because of a fall in crude prices. All this kept government expenditures at budgeted levels and allowed it to stick to the fiscal consolidation path. Capital expenditures rose substantially.

Pay Commission burden

The fiscal picture for 2016 however is going to be tough. The additional burden imposed by the Seventh Pay Commission is substantial. The expenditure on pay and pension will increase by 20 per cent and it will amount to a burden of 0.4 per cent of GDP, after taking into account the additional tax revenue on the increased emoluments.

Against this background, the ability of the government to raise money for capital expenditures will be limited. However, relaxing the fiscal consolidation path is not a solution. There is some validity in the argument that the desired level of fiscal deficit should depend upon the phase of the cycle. However, our experience shows that even in the years when the economy was doing well, we were not able to abide by the mandated level, let alone improve upon it. A larger fiscal deficit will not only take up a greater share of the available pool of savings but also cause an increase in the interest rates. This is hardly conductive to a growth in private sector investment.

Private consumption may show a rise, particularly because of the additional income in the hands of government employees. This has happened in the past every time a pay commission's recommendations have been implemented. The hope for a substantial growth in 2016-17 thus revolves around the behaviour of private corporate investment or private investment in general.

The present position of private corporate investment is that while there has been some improvement in relation to stalled projects, there is no strong pick up in the new projects. This situation has to change, if the pace of the recovery is to speed up this year.

The corporate sector faces several internal problems, including a slow growth in nominal sales revenue and high levels of debt. For the investment climate to improve, investors' confidence in the system must be enhanced. The government has an important role to play here.

It is true that the reform agenda of the government has been stymied because of logjam in Parliament. But much can be done to restore and enhance confidence even within the present structure. The government can easily remove cumbersome rules and procedures and tone up the delivery system.

Globally, the prognosis for 2016 is not that good. Among the major advanced economies, the only country that can show some improvement is the United States. Among the emerging economies, the slowdown in the performance of China and the consequent further devaluation of yuan may have serious spillover effects.

India's growth performance in 2015 was certainly a bright spot. It has, however, fallen short of our expectations and needs. A strong recovery is possible in 2016 with growth rate exceeding 7.5 per cent but that is contingent on private investment, particularly private corporate investment, showing substantial improvement. Creating a proper investment climate is the need of the hour.

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