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Getting India Back to the Turnpike: What will it Take?

Rakesh Mohan
Senior Fellow
Jackson Institute for Global Affairs
Yale University
And
Distinguished Fellow
Brookings India

George Washington University
Washington DC
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Getting India Back to the Turnpike: What will it Take?

- **Introduction**
- The Indian Economy: A Story of Consistent Growth
- Getting Back to the Turnpike: A Simulation for 2017-32
- Policy Imperatives for Getting Back to the Turnpike
- Conclusions

Introduction (1)

- India's Recent Growth Trajectory
  - The Golden Era 2003-08
  - Growth Pause 2008-09
  - Continued Growth 2009-12
  - The Great Slowdown 2013-14
- Can India Get Back to Sustained High Growth?

Introduction (2)

- The Global Economic Environment
  - Global slowdown caused by North Atlantic Financial Crisis
  - European Sovereign Debt and Banking Crisis, 2010
  - Protracted Recession in Advanced Economies, particularly Europe
  - Global Trade Slowdown
  - Possibility of Secular Stagnation
- Can India Get Back to Sustained High Growth?

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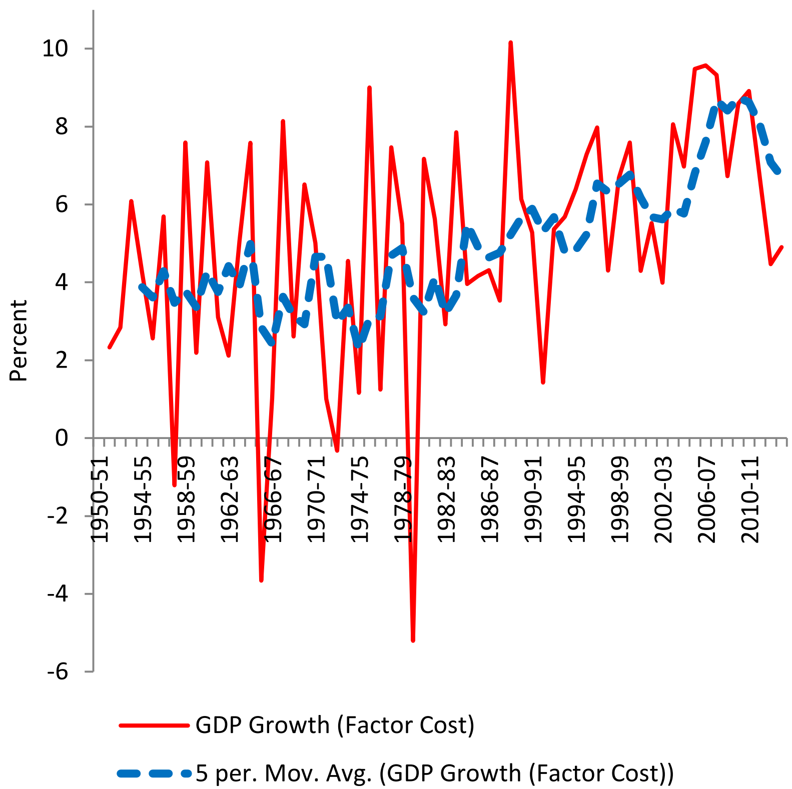
The Indian Economy: A Story of Consistent Growth

- A Story of Sustained Growth
  - Consistent Acceleration Since Independence
    - Interregnum 1965-81
  - Mostly Financed by Rising Domestic Savings
  - High Industrial Growth 6-7 per cent
    - Except 1965-81
  - Variable Agriculture Growth
  - Consistent Acceleration in Services
    - Not just Recent

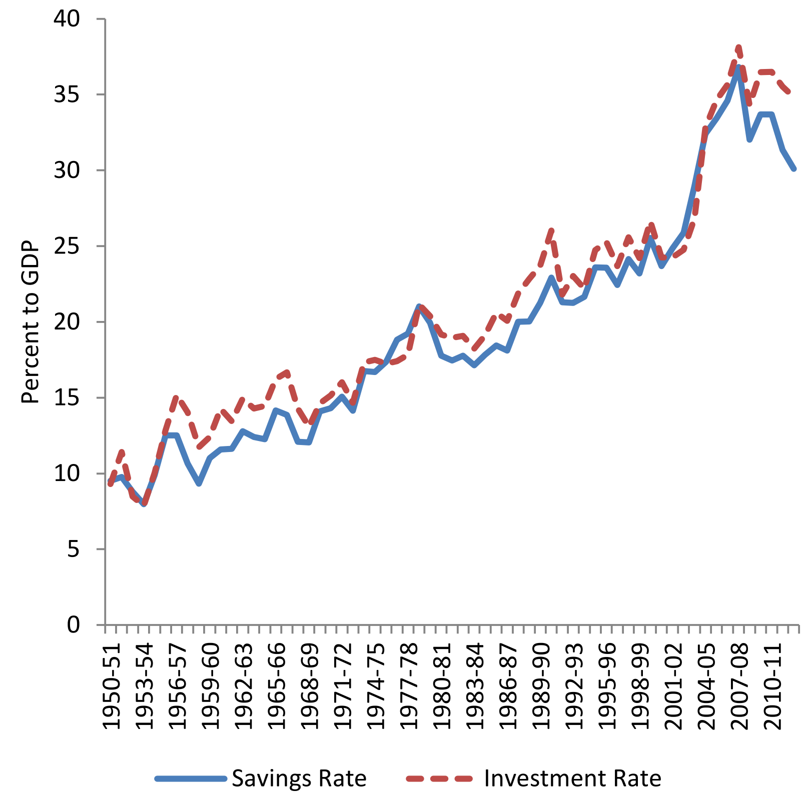
Indian Growth Record (1)

Consistent Acceleration and Domestically Financed

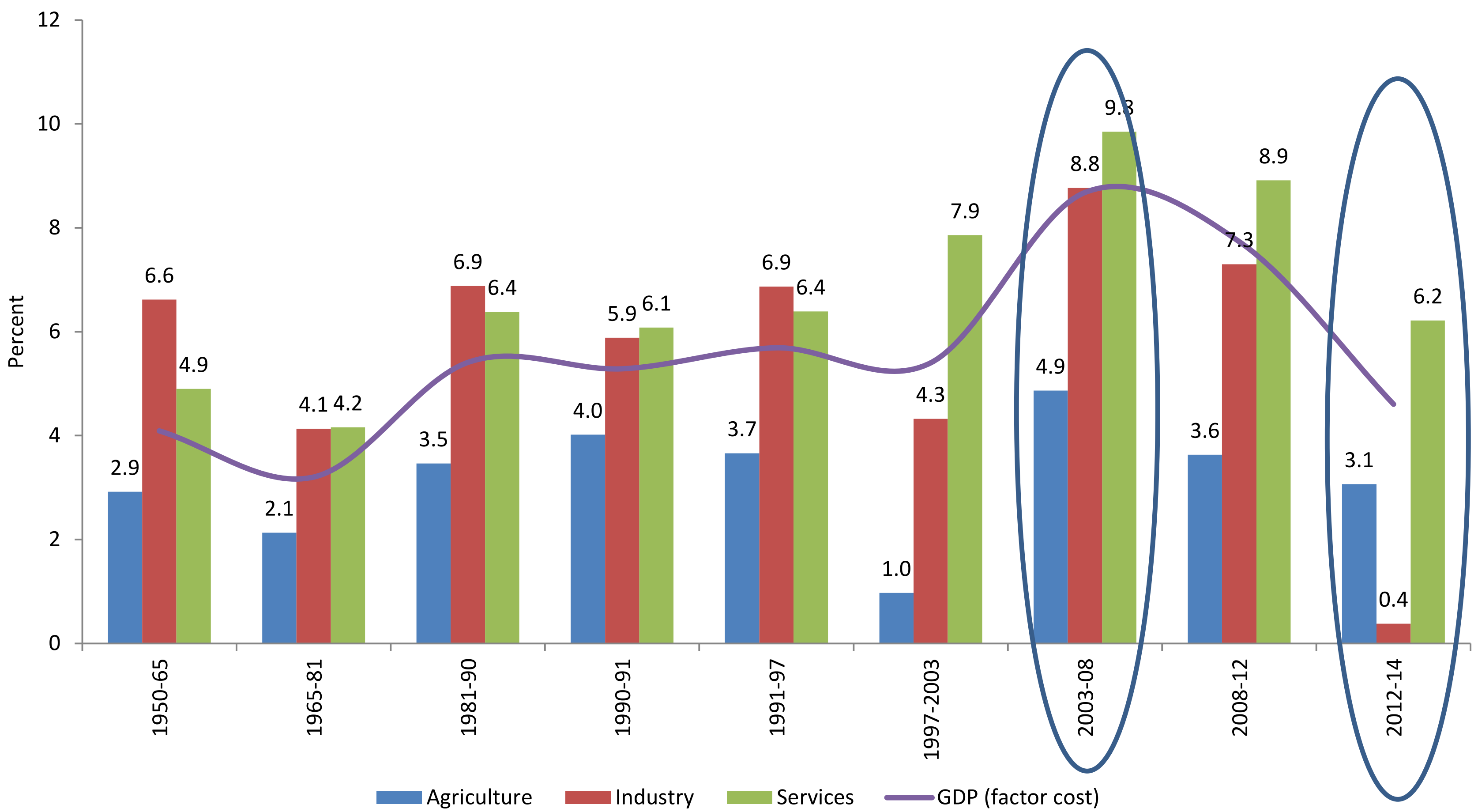
GDP Growth



Savings and Investment

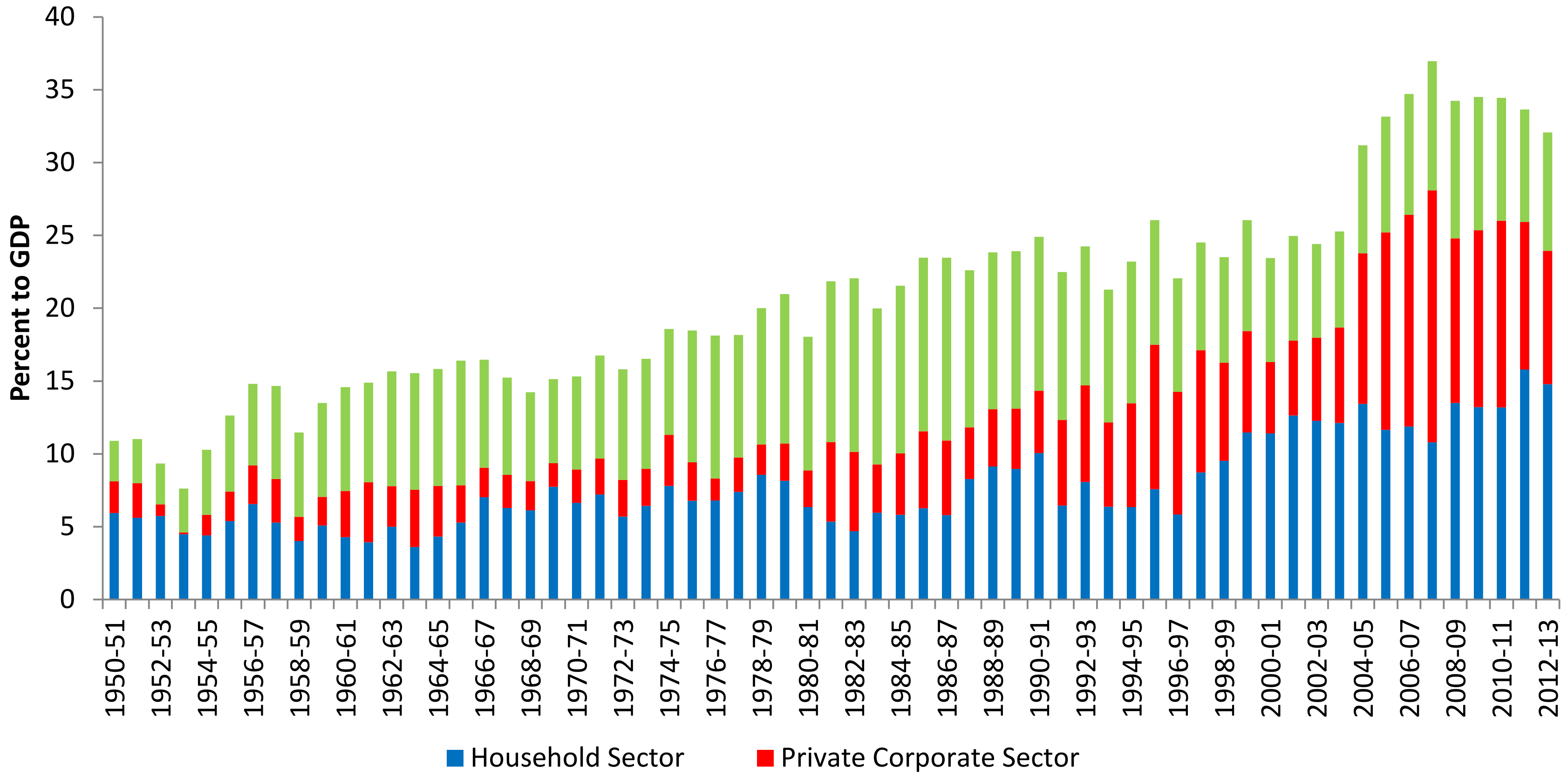


Indian Growth Record (2)



Investment

Both Public and Private Sectors are Drivers



Deterioration in public savings between late 1990s and early 2000s – also a period of slow growth. Improvement between 2003 and 2008, associated with growth acceleration.

The Golden Era of Growth (1)

- Prudent Fiscal Policy
  - Combined Fiscal Deficit Halved
  - Improvement in Tax GDP Ratio
  - Subsidies Controlled
  - Increased Public Investment
  - Growth in Public Sector Savings

The Golden Era of Growth (2)

- Complex Monetary and Financial Management
  - Low Inflation
  - Low interest rates
  - High and Volatile Capital Flows Managed
  - Floating but Managed Exchange Rate
  - Banking Regulation and Supervision Tightened
  - High Credit Growth
  - High Banking Quality

The Golden Era of Growth (3)

- Corporate Sector
  - Sustained Growth in Profitability
  - Availability of Own Savings
  - No Crowding Out
  - Step Up in Corporate Investment
- Households
  - Continued Growth in Financial Savings
  - Robust Consumption Demand
  - Housing Investment

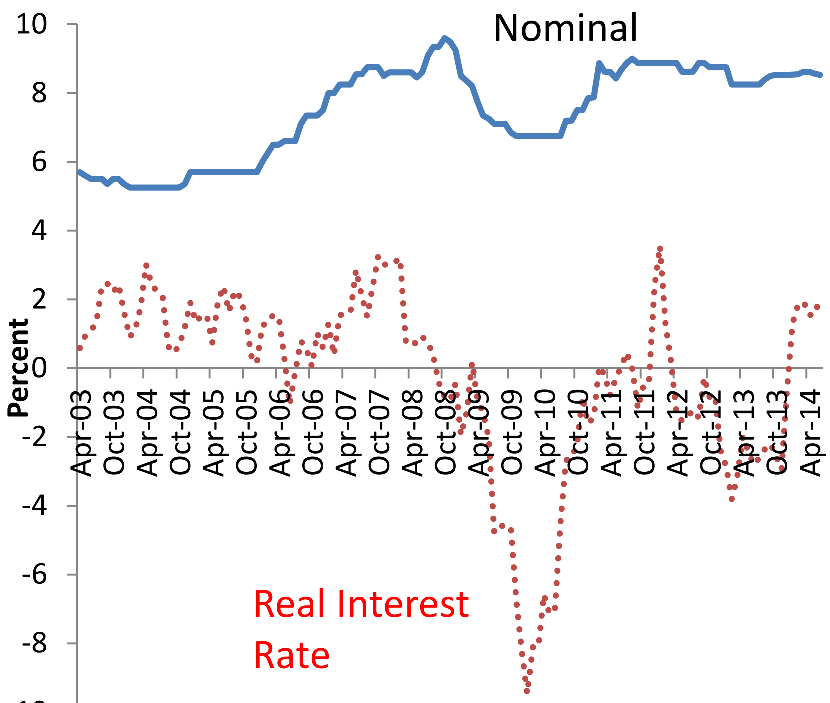
The Great Slowdown 2012-14 (1)

- Excess Fiscal and Monetary Stimulus 2008-09
- Some Revival of Growth 2009-12
- Poor Quality Fiscal Stimulus
  - Tax Cuts
  - Increase in Subsidies
  - Reduced Public Investment
- Hesitant withdrawal of Fiscal, Monetary Stimulus
- Revival of Capital Flows, not Managed

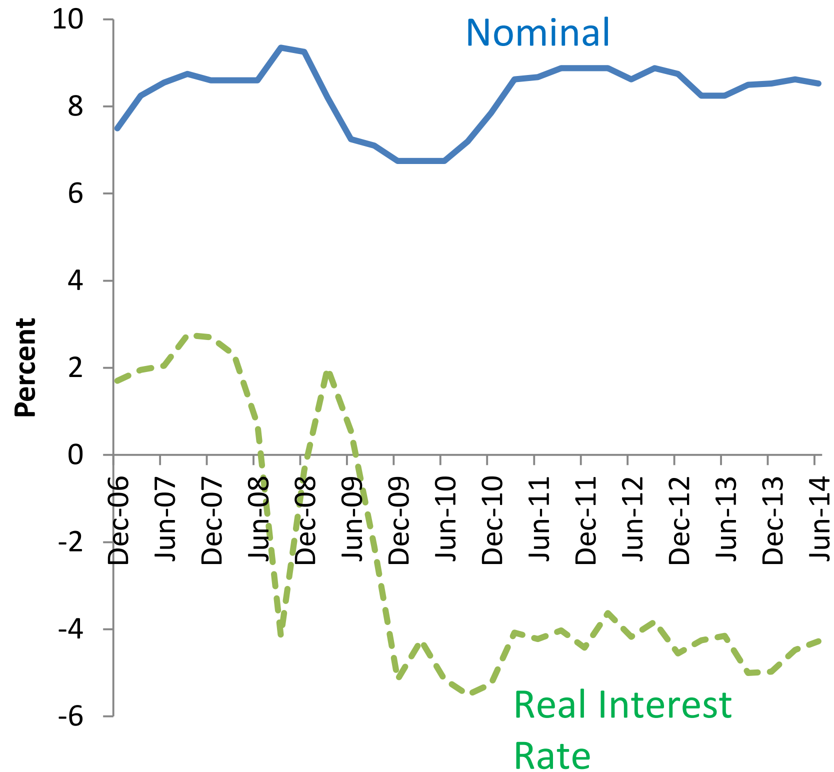
The Great Slowdown 2012-14 (2)

- Consequences
  - High Food Inflation/Overall Inflation: Corrected
  - Crowding Out of Private Corporate Sector: Corrected
  - Real Exchange Rate Appreciation: Continues
  - Increase in Current Account Deficit: Corrected
  - Fall in Savings Rate: Continues
  - Fall in Corporate Investment: Continues
  - Fall in Export Growth: Continues
  - Collapse of Manufacturing Growth: ?

Real Deposit Rates: Negative



Note: Real interest rate is nominal deposit rate less y-o-y CPI (Industrial Workers) inflation.



Note: Real_One_Year_Ahead is nominal deposit rate less "one year ahead" inflation expectations of households as per RBI's survey.

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A Macro Economic Approach – RMSM-X model

- **Model projects investments possible in economy over next 20 years**
  - Reflects change between past trends and future estimates based on key economic assumptions
  - Highlights financing gap for the economy
  - Infrastructure investments and gaps can be derived
- **Ensures consistency between projections of balance of payments and national accounts**
  - Bottom-up sector-specific financing needs may be much higher than what is feasible for the economy based on macroeconomic scenario
- **Model estimates to be interpreted as broad ranges**
  - Objective is to present a broad idea of magnitudes implied by a relatively optimistic growth scenario

Key Assumptions

Economic growth

- Agriculture 4% p.a. [share in GDP declining]
- Manufacturing 8 - 10% p.a. [share in GDP: slight increase]
- Services ~ 9% p.a.

ICOR

- Incremental Capital Output Ratio ~ 4

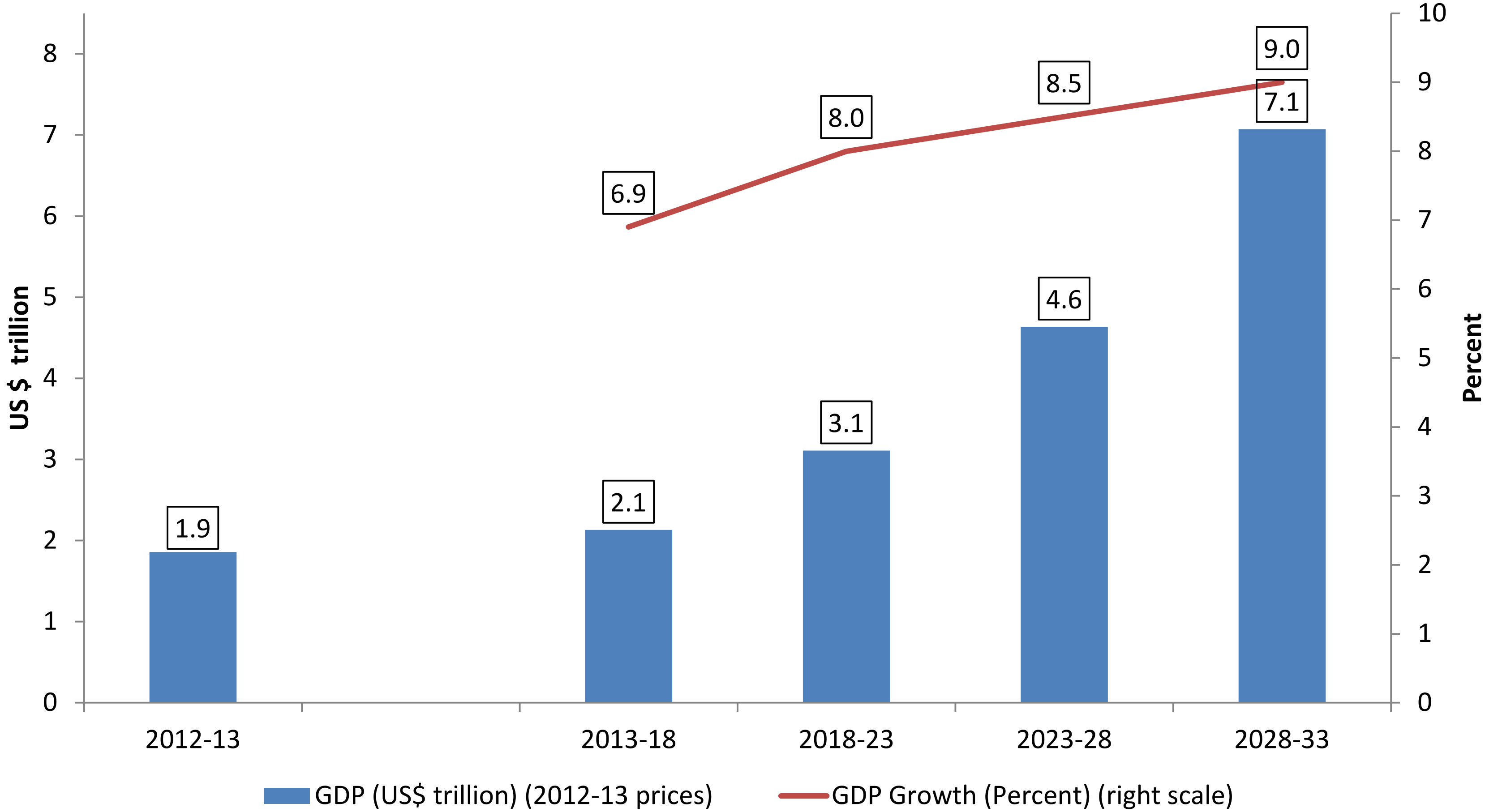
External sector

- Exports (goods) grow around 12%
- Imports (goods) grow around 10-11%

Infrastructure investment

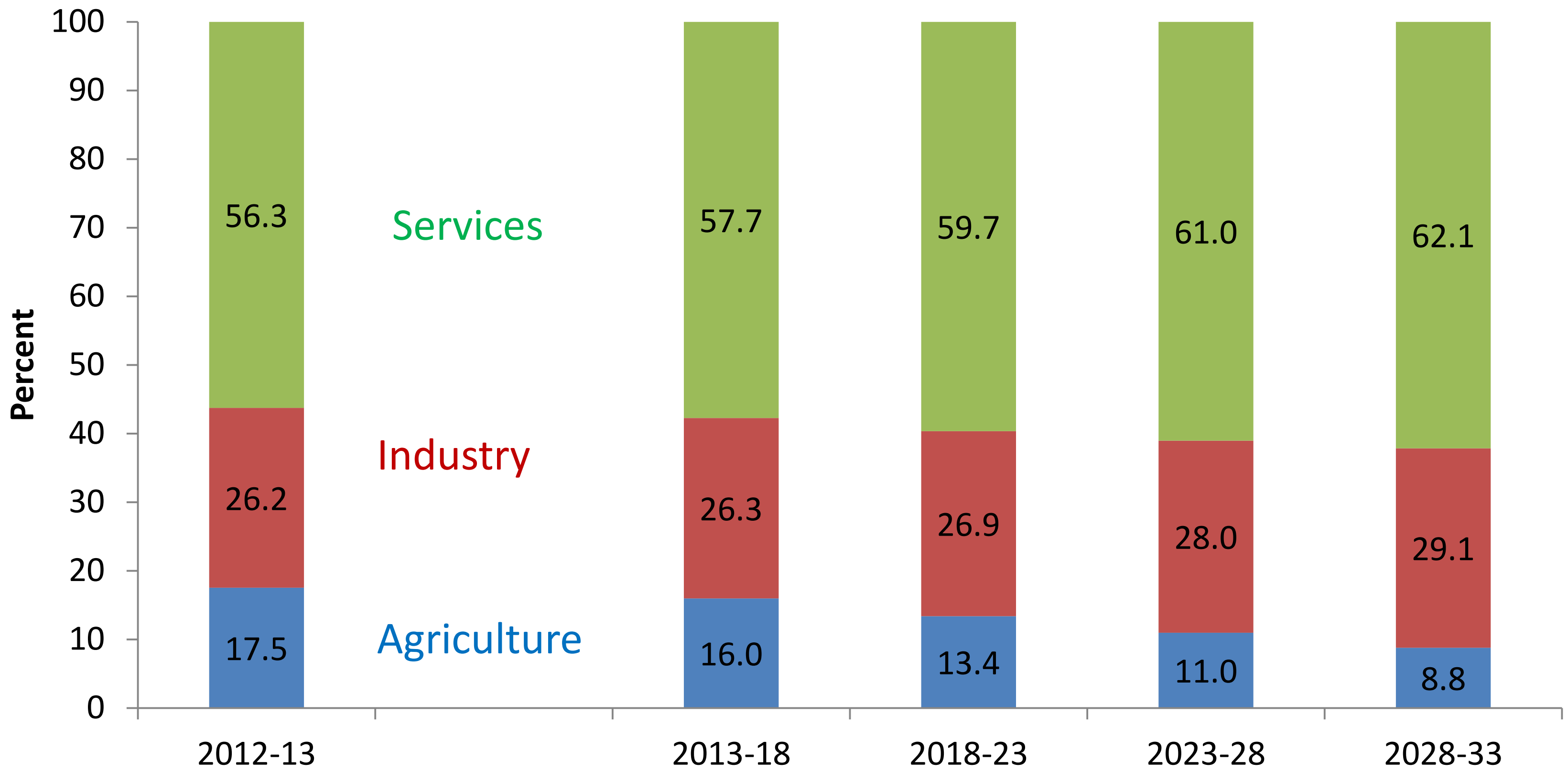
- Infrastructure includes railway, other transport, road and bridges electricity, water and gas supply, and communication
- Infrastructure investment : from 5.4 % of GDP (2011-12) to around 8% (2017-32)
- Shares in GDP based on national accounts

GDP Trajectory



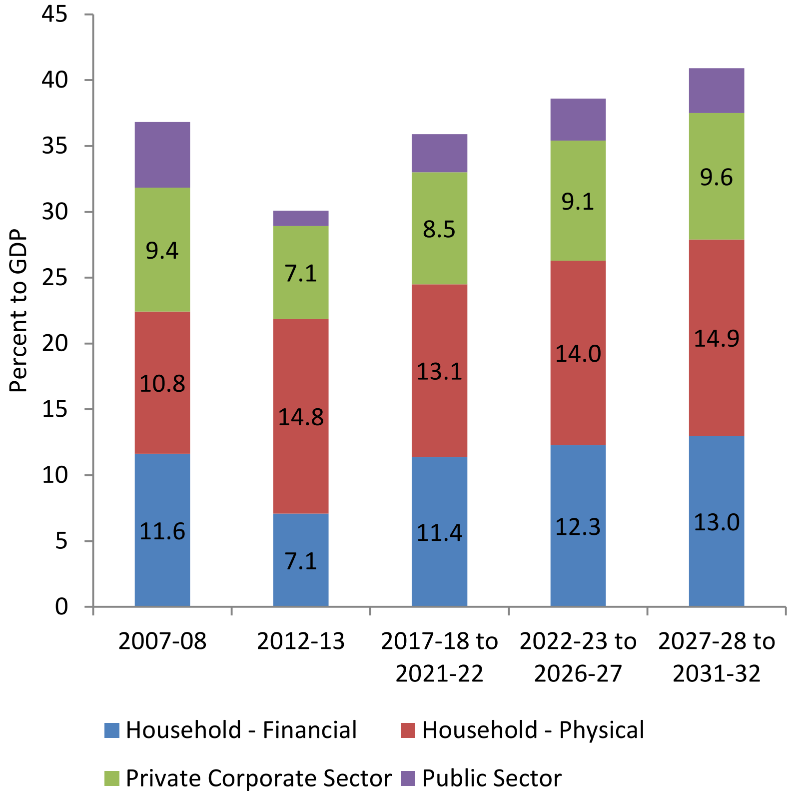
GDP: Sectoral Trends

Manufacturing Growth Needs to Rise to 10%

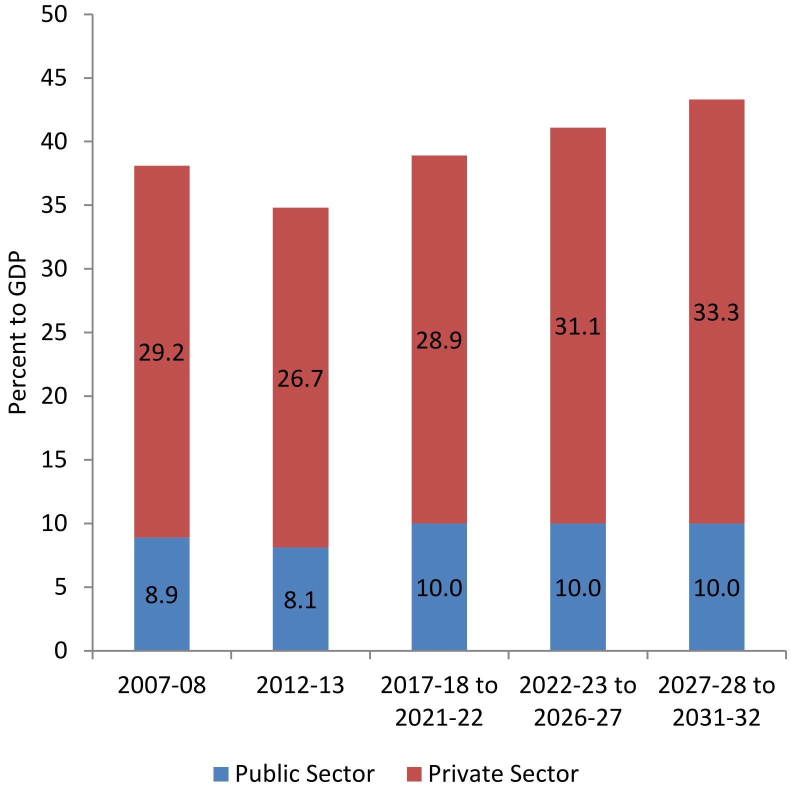


Savings and Investment Requirements

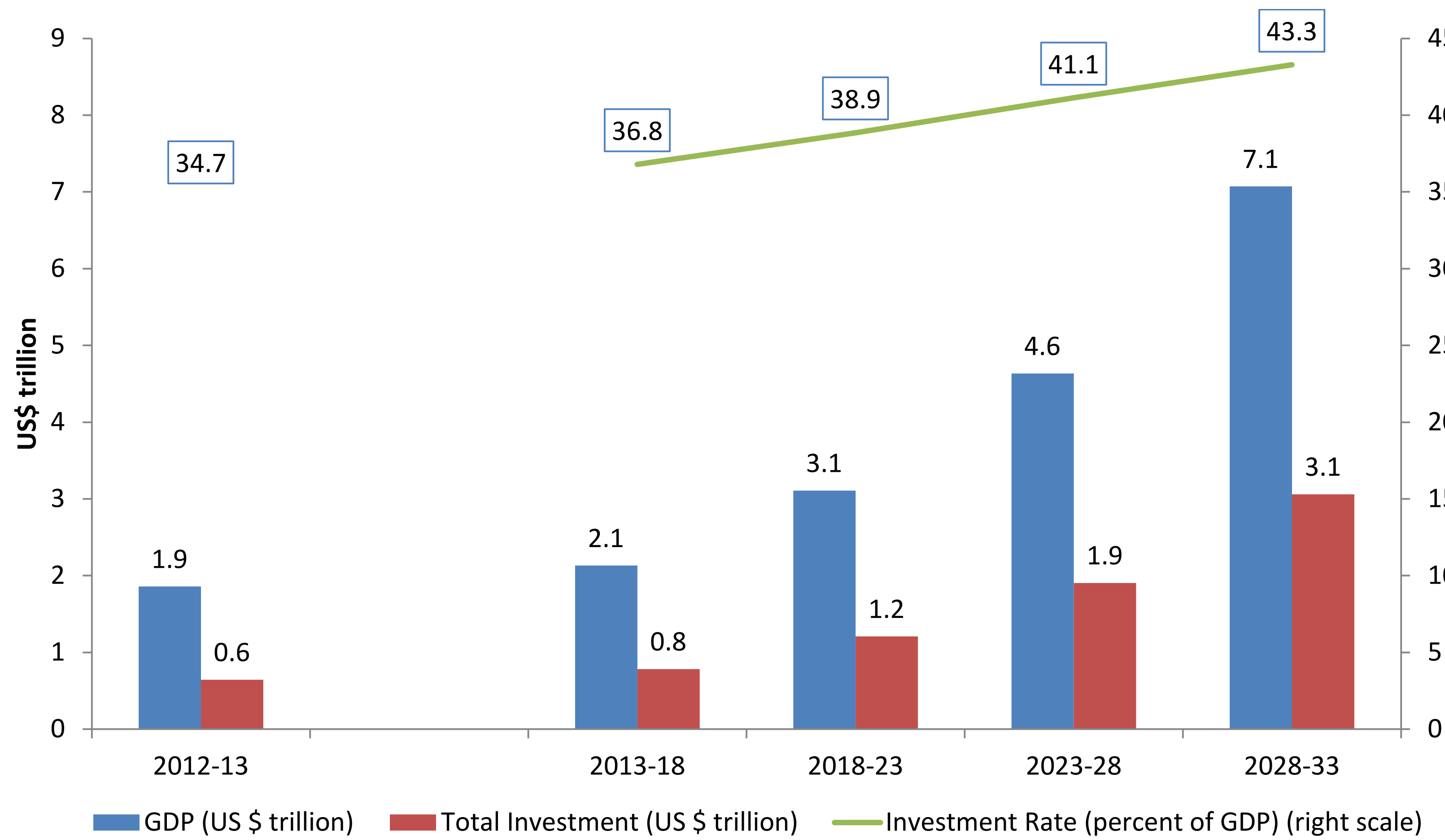
Savings



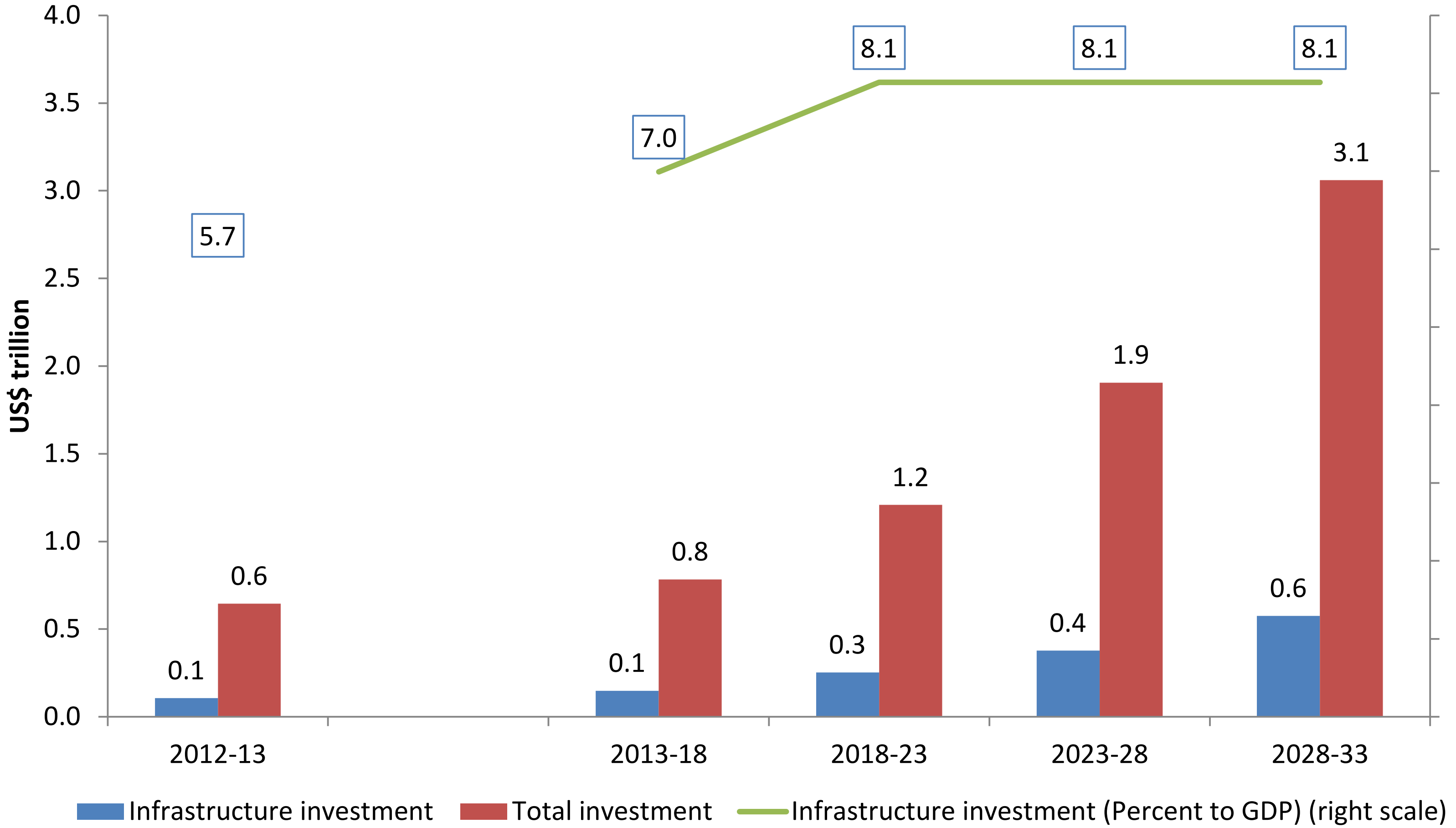
Investment



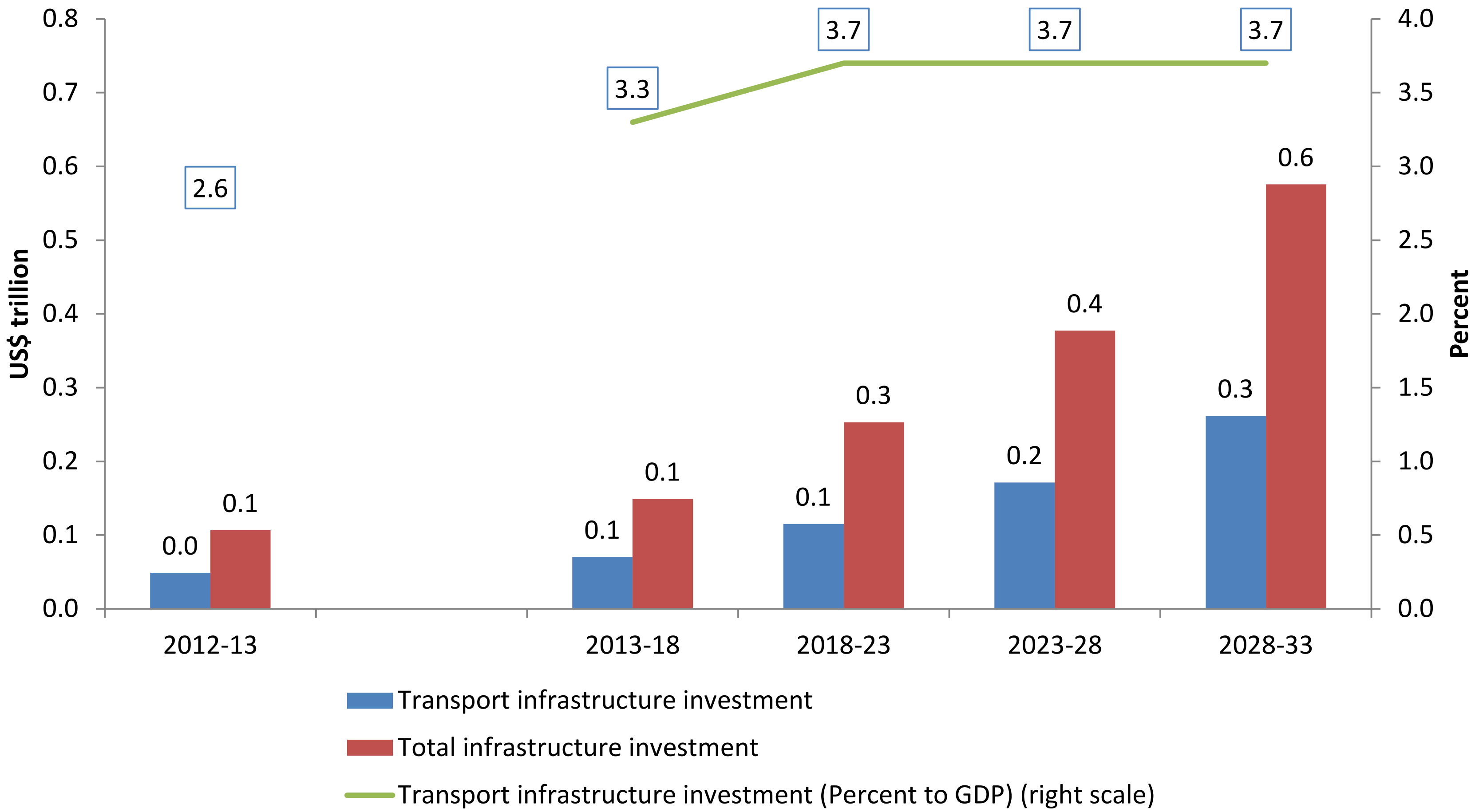
Investment Trend



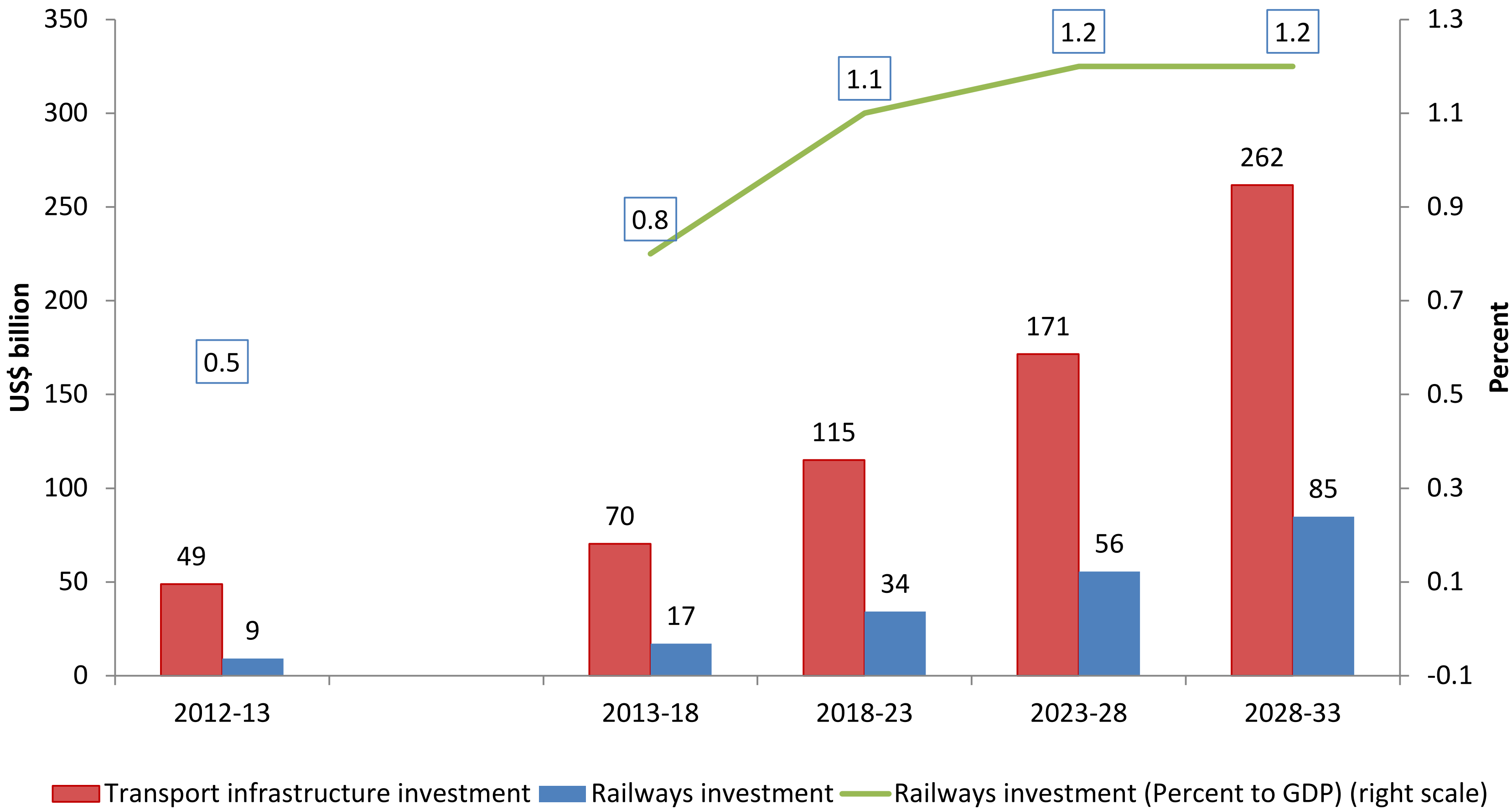
Infrastructure Investment



Transport Investment



Railways Investment



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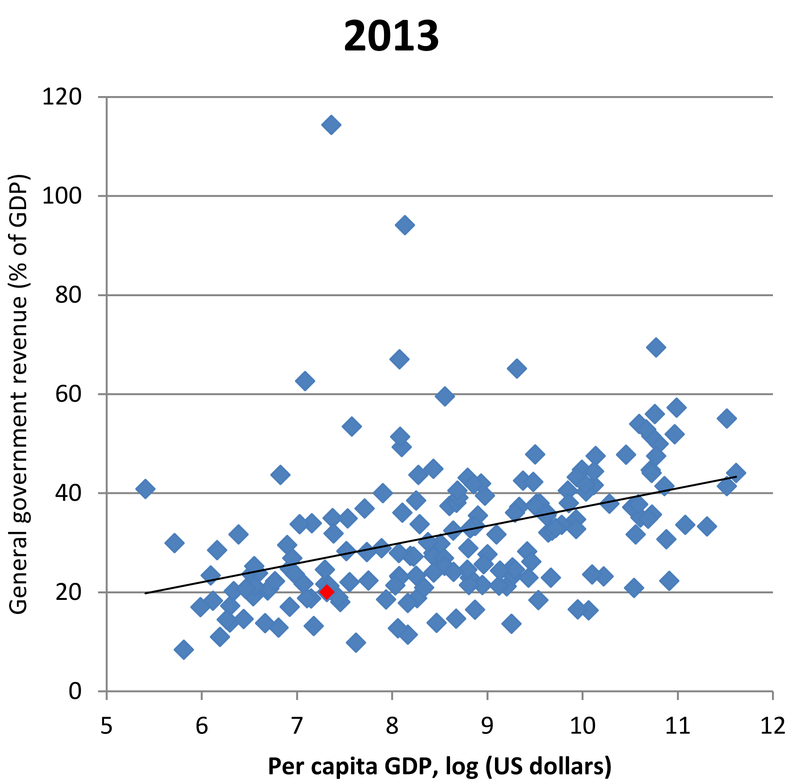
Policy Imperatives for Higher Growth (1)

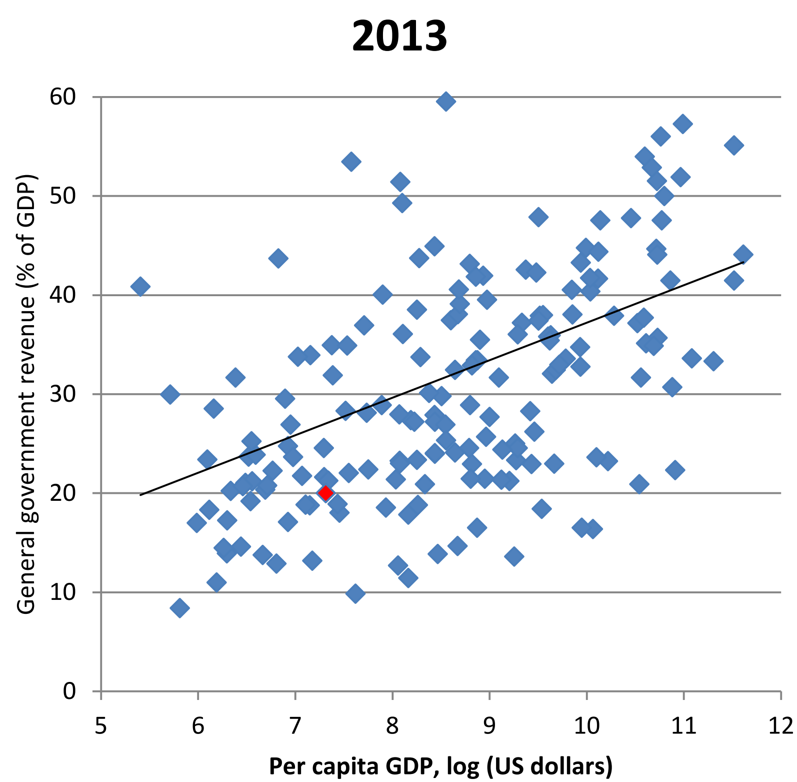
- Public Savings and Fiscal Policy
- Fiscal Consolidation: A Necessary Condition
  - Restrain Subsidies to around 1 per cent of GDP
    - Deregulate diesel prices ✓
    - Progressively deregulate kerosene/LPG prices ✓ ?
    - Necessary for fuel efficiency ✓
  - Increase Tax GDP Ratio to around 18 per cent
    - Implement GST ✓
    - Reduce Tax Expenditure ?
    - Enforce Income Tax Compliance ?
      - ➢ 65,000 Black Money Declarers; Average Rs 10 million
- Increase Public Investment in Infrastructure ✓ ?

General Government Revenues: Cross-Country Perspective

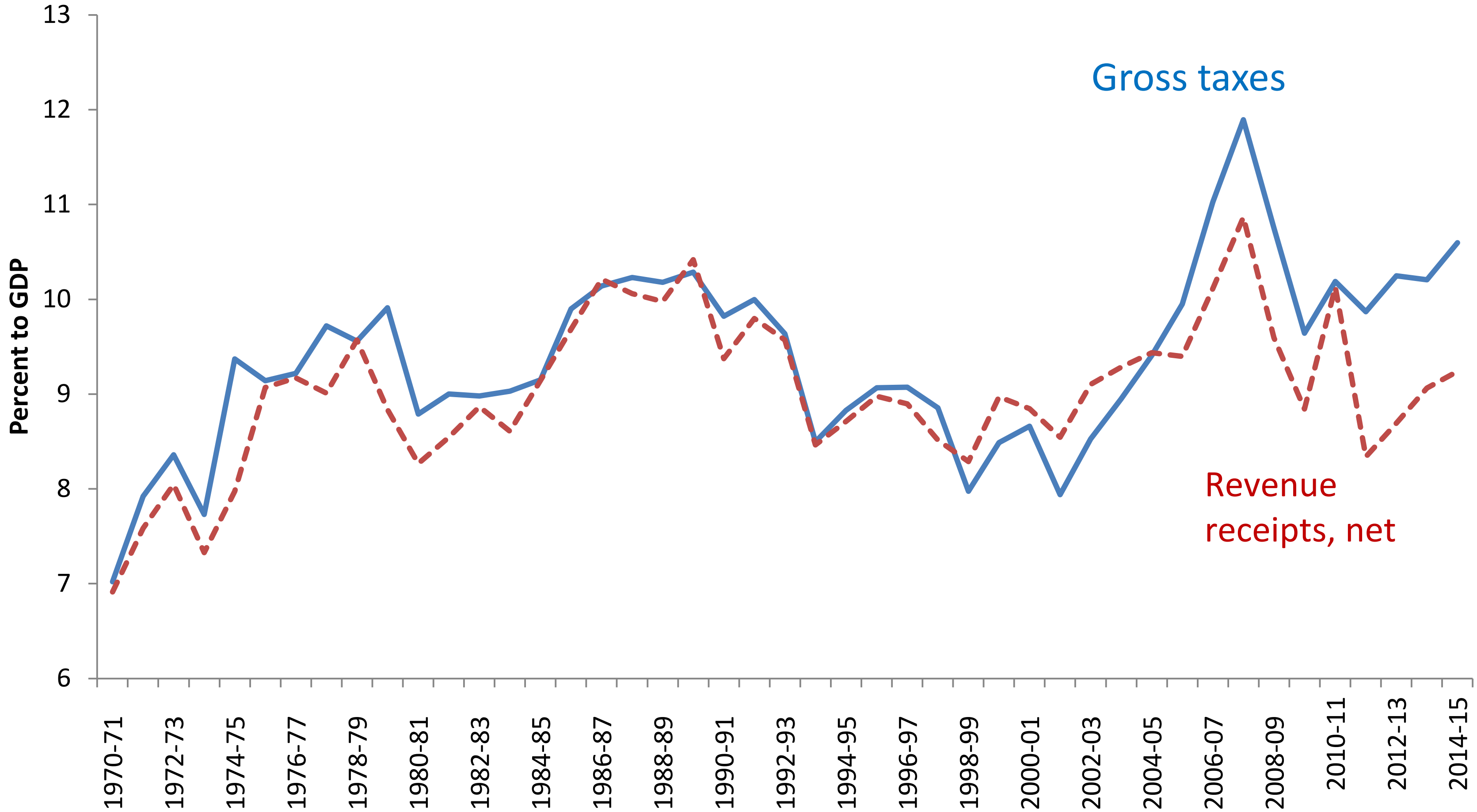
All countries



Countries with revenue/GDP ratio above 60 percent dropped



Central Government Revenues



Policy Imperatives for Higher Growth **(2)**

- Household Savings
  - Monetary Policy for Maintaining Low Inflation ✓
    - Hence positive real deposit interest rates
  - Contain food inflation: Food Supply Chain ?✓
  - Strengthen Contractual Saving ?
    - Pension Schemes
    - Mix of defined benefit and contribution
    - Provident Fund
    - Life Insurance

Policy Imperatives for Higher Growth (3)

- Private Corporate Sector
  - Reduce Crowding out ✓
  - Manage Competitive Real Exchange Rate for Manufacturing ?
  - Focus on Manufacturing
    - Make in India: But ?
    - Urban Land and Labor Reforms ?
    - SEZs for Labor Intensive Manufacturing ?

Policy Imperatives for Higher Growth (4)

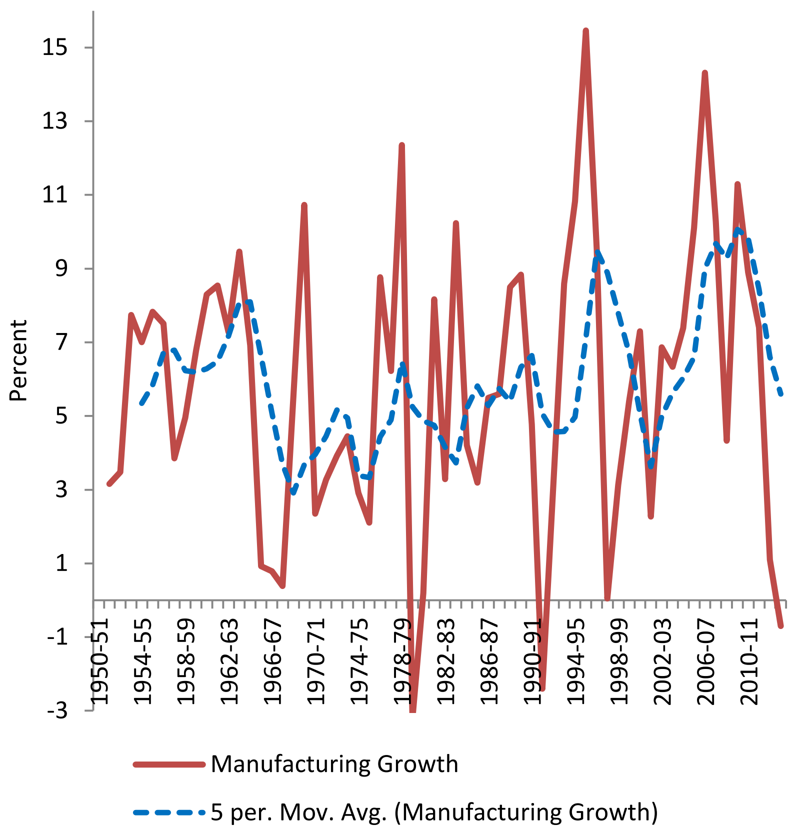
- Foreign Savings and Capital Account Management
  - Maintain judicious Current Account Deficit ≦ 2.5 per cent ✓
  - Continue Active Capital Account Management
    - Calibrate External Debt Flows Carefully ✓
      - External Commercial Borrowing ✓
      - Limited Opening of Domestic Debt Market ✓
        - But Opening of Domestic Bond Market ?
      - Banking subject to Macroprudential Regulations ✓
    - Encourage FDI ✓
    - Continue Foreign Equity Portfolio Investments ✓
  - Accumulate foreign exchange reserves
    - @ 6 months imports ✓
    - ~ 2 per cent of GDP ✓
  - Need Net Capital Flows ~ 4.5 per cent of GDP ?

Policy Imperatives for Higher Growth (5)

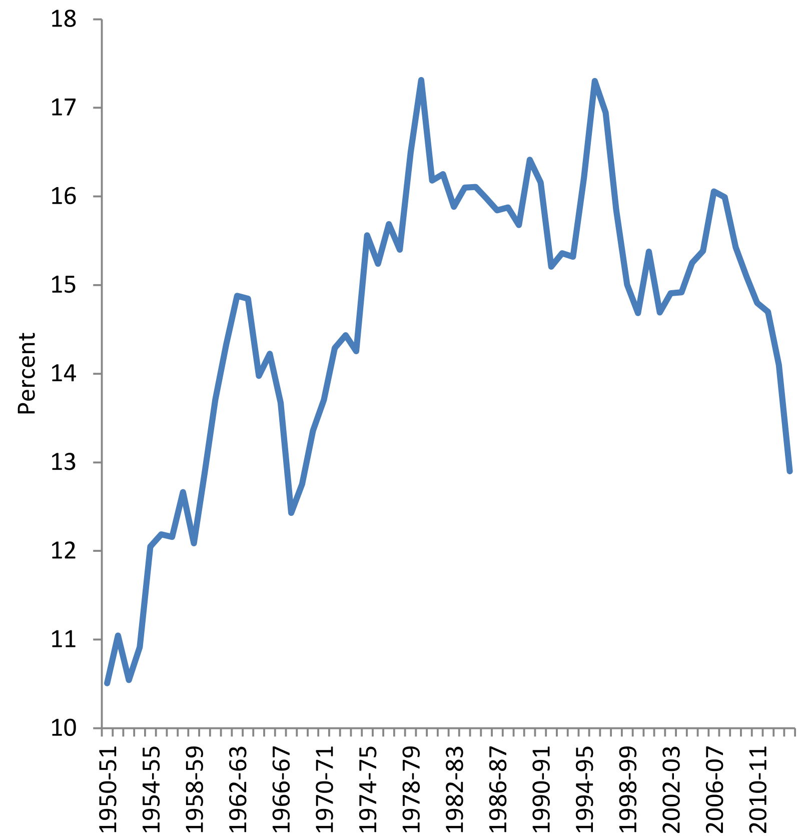
- Structural Reforms: Acceleration in Manufacturing Growth
  - Promote Labor Using Manufacturing ?
  - Labor Legislation Reform ?
  - Urban Land reform ?
  - Environmental and Other Approval Process ?
  - Special SEZ for Labor Using Manufacturing ?
  - Active sourcing of Chinese manufacturing ?

Indian Manufacturing:
Continues to Underperform

Manufacturing Growth



Share of Manufacturing in GDP



Manufacturing: India and Asia

Economy	Share in Output			Share in Employment		
	Data since	Year of highest share	Value of highest share	Data since	Year of highest share	Value of highest share
Azerbaijan	1990	1992	23.9	1983	1983	18.3
Bangladesh	1980	2011	18.2	1984	1989	13.9
Cambodia	1993	2004	19.9	1993	2006	10.8
China	1965	1978	40.5	1978	1988	15.9a
Hong Kong	1970	1970	29.6	1974	1976	45.3
India	1960	1979	17.3	1960	2002	12.9
Indonesia	1960	2001	29.1	1971	1994	14.7
Korea, Rep. of	1965	1988	30.7	1963	1989	28.7
Kyrgyz Rep.	1990	1992	33.7	1986	1990	17.0
Malaysia	1960	1999	30.9	1975	1997	27.6
Pakistan	1970	2008	19.7	1973	1982	14.5
Philippines	1960	1973	26.6	1971	1971	11.5
Singapore	1975	2004	27.5	1970	1981	30.4
Sri Lanka	1960	1977	23.1	1990	2006	19.2
Taipei,China	1960	1986	39.2	1963	1987	35.2
Thailand	1960	2007	35.6	1960	2007	16.4
Memo:						
Average			27.8			20.8
OECD			25.9			25.7

a This refers to both urban and rural manufacturing employment. Available data for employment is only up to 2002.
The share of urban manufacturing in total manufacturing employment is about 28% (for 2000–2010).
OECD output and employment averages refer to 23 countries.
Source: Key Indicators for Asia and the Pacific 2013.

Policy Imperatives for Getting Back to the Turnpike (6)

- Transport Infrastructure
  - Office of Transport Strategy ?
    - Central Government
    - State Governments
  - Railways
    - Organizational Reform ?
    - Corporatization ?
    - Accelerate Dedicated Freight Corridors ?
    - Focus on Energy Commodities Transportation ?
    - Modernization of Rolling Stock ?
    - Need for at least 2 Mega Ports ?
    - Coordination of Road and Rail Investment ?
  - Arrangements for Multimodal Transport ?
    - Logistics Parks

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Conclusions

- Return to Growth Turnpike Feasible
  – Fiscal Consolidation
  – Low Inflation
  – Revival of Manufacturing
  – Competitive Real Exchange Rate
  – Step Up in Investment in Energy and Transport

THANKS