OP Jindal Lectures with Raghuram Rajan- India in the World: The “Vision” Thing

Presented by- Ankit

Introduction

In this Lecture given by the Raghuram Rajan, 23rd Governor of Reserve Bank of India (tenure period September 2013- September 2016) at Brown University in OP Jindal Lecture Series especially designed for Indian students.

The Jindal Distinguished Lecture Series was endowed in perpetuity by Sajjan and Sangita Jindal to promote a serious discussion of politics, economics, social and cultural change in modern India.

Outline of talk-

- ❏ India has slowed considerably

- ❏ Investment has been slowing for a long time, but consumption has joined in.

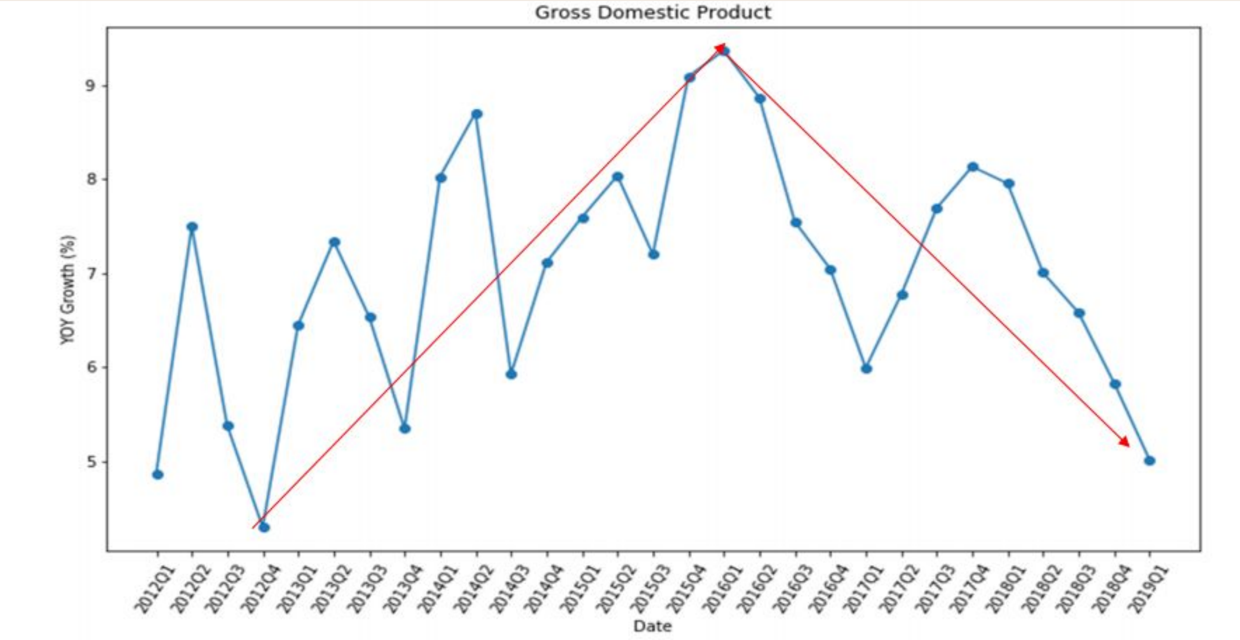
- ❏ Legacy problems such as financial or power sector stress have not been fully resolved and financial stress is growing again.

- ❏ The lack of sustained reforms since 2004, especially in improving the quality of, and access to, factor markets such as land, labor, logistics, and power is-
  - Holding back investment
  - Reducing job growth
  - Reducing income growth, increasing borrowing, and reducing consumption growth

- ❏ Modi- I conceived actions like demonetization and poorly executed ones like the GST rollout have further stressed the economy.

- ❏ India cannot sustain spending on its expanding welfare programs without growth. Something will have to give.

Comparing Growth and de-growth (UPA II and Modi I)



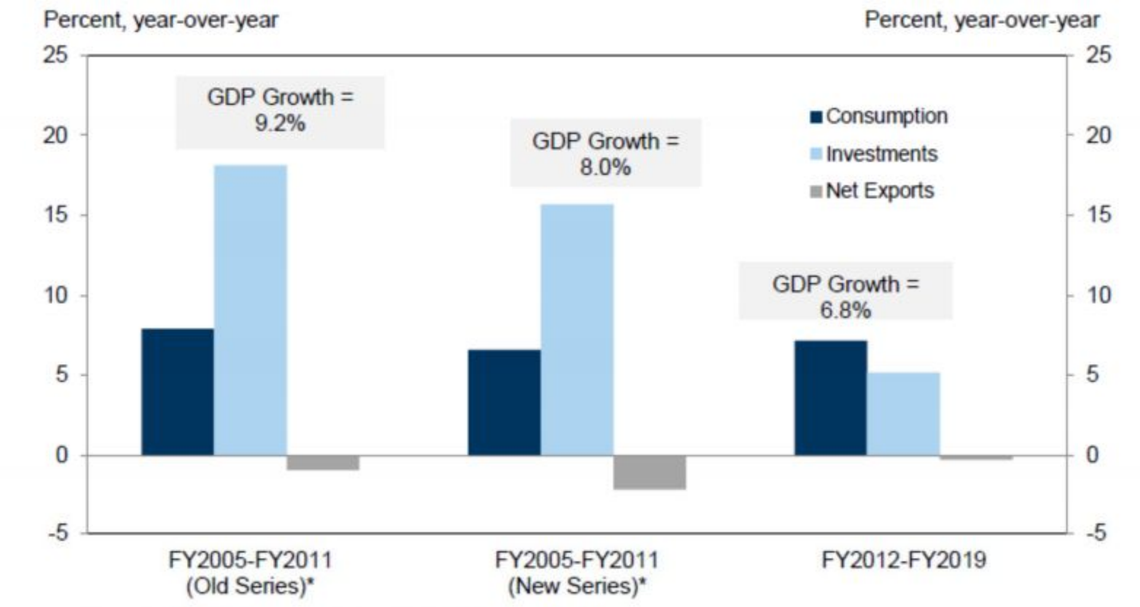
Source : Ministry of Statistics and Programme Implementation.

Here, in the graph Blue color shows the change in GDP every quarter and Red color arrow shows that how GDP has rise and then fall after reaching a 9.5% growth rate.

Why there is so much fluctuation in GDP?

- ❏ We were growing really fast before the Great Recession and then 2009 was a year of very poor growth we started climbing little bit about it after it.
- ❏ But since 2012 we’ve had a steady upward movement in growth going back to the pre 2000 pre-financial crisis growth rates.
- ❏ In early mid 2016 we’ve seen a steady deceleration.
- ❏ Now latest no were 5% for the last quarter but when you look some investment bank projections they don’t look happy it doesn’t look like there’s going to be a rebound in the very short run.

Long run trends => Investment growth falling



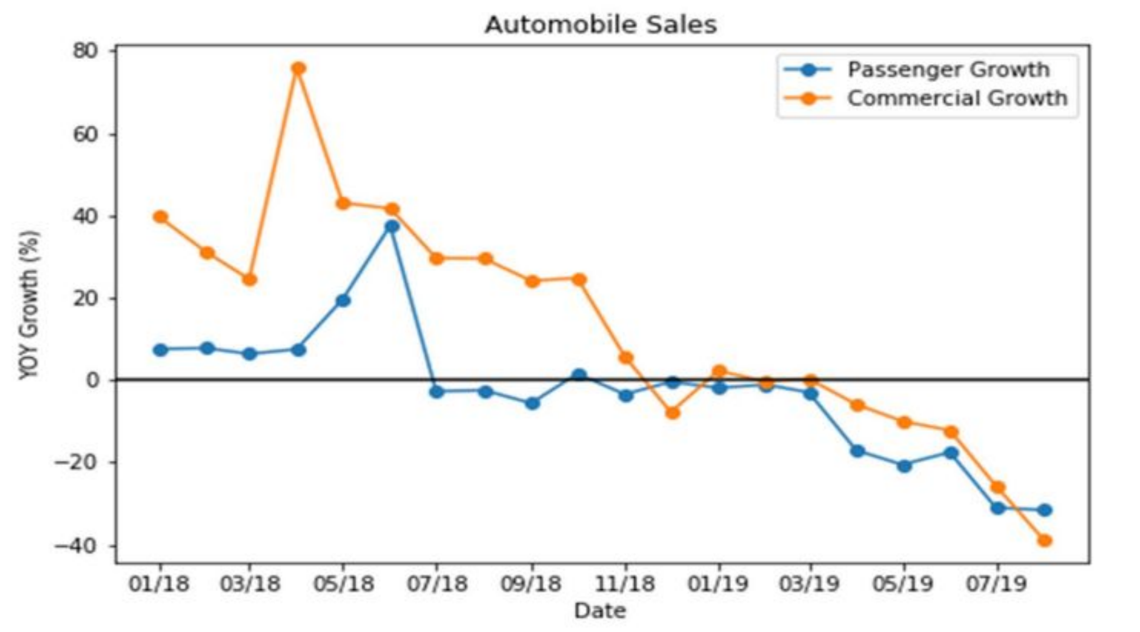
Source: Haver Analytics, Goldman Sachs Global Investment Research

*Excludes 2009, the year of the Global Financial Crisis

There are few reasons due to which Investment Growth start falling and some of them are-

- ❑ Investment has been falling steadily in the Indian Economy ever since probably the global financial crisis but it's been falling steadily.
- ❑ Consumption had been relatively strong and holding up across these two periods but more recently consumption has also been falling.
- ❑ Net Exports were never a strong source of additional growth.

Trade Balance - Exports have shrunk as a fraction of GDP



Source: Automotive Industry Portal Marklines

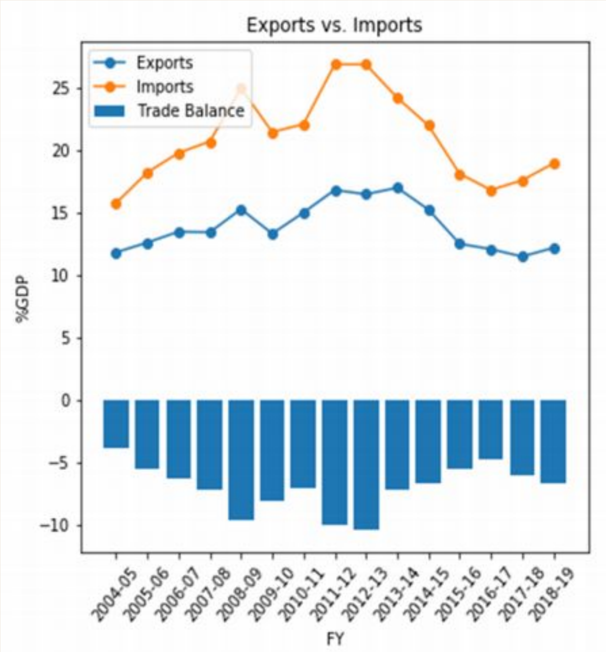
1. Consumption is falling rapidly if you look at the every element of the auto industry look at cars, commercial vehicles and two wheelers-

- Two wheelers are a good proxy for rural demand
- Commercial Vehicles are good proxy for industrial demand
- Cars are good proxy for urban demand

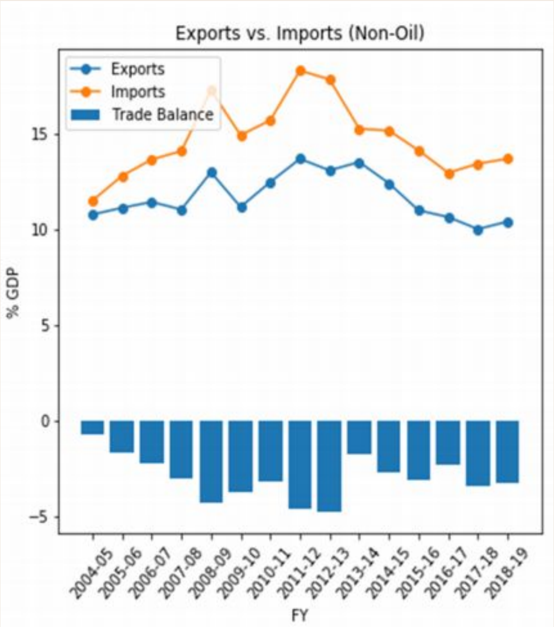
2. It leads to extend upto 30-40 % negative growth.

3. Some of it is because of policy changes like change in emission requirements, uncertainty about whether value added tax is changed for this. VAT come down from 28% for cars because I might wait and see before buying a car because it does make a lot of difference in the price of car

Consumption was propping up growth - but it is slowing fast too



Source: Reserve Bank of India



Source: Reserve Bank of India

General Government fiscal deficits - Officially 7%

- ❏ But estimated budget revenues are optimistic for both center and states government
- ❏ Corporate tax cut adds to burden
- ❏ Off-balance sheet borrowing (FCI, NHAI, PSB borrowing to pay government dividends) is skyrocketing
- ❏ Contingent liabilities (NPAs, need for recapitalization and bailouts, healthcare commitments) rising
- ❏ Public sector borrowing requirement rising – between 9 and 10 percent of GDP today
- ❏ Private debt and distress are growing

[Note- A **fiscal deficit** is a shortfall in a government's income compared with its spending. The government that has a fiscal deficit is spending beyond its means. A fiscal deficit is calculated as a percentage of GDP, or simply as total dollars spent in excess of income.

NPA- Non Performing Assets, FCI- Food Corporation of India, NHAI- National Highways Authority of India, PSB- Punjab and Sind Bank]

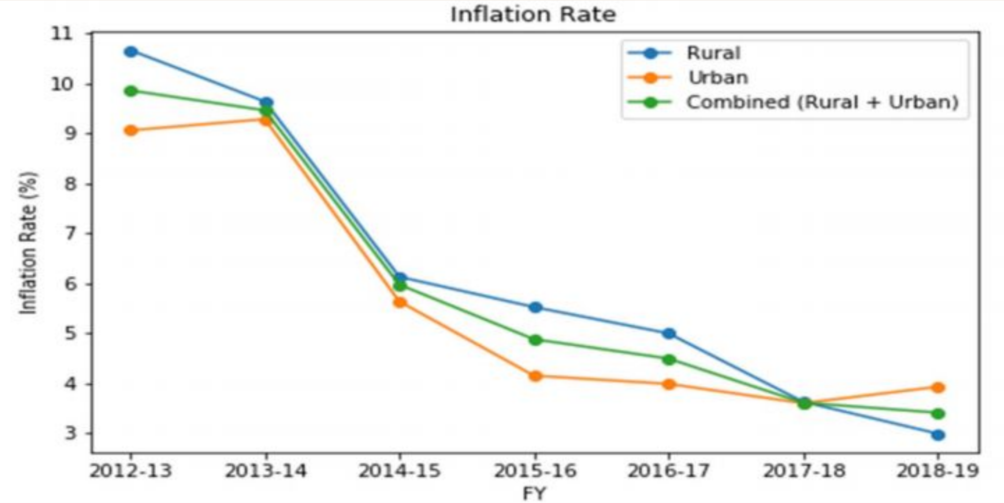
Growth-friendly liberalizing reforms scarce

- Corruption Scandals during UPA II (2009-2014)
  - Slowed further growth reforms as opposition turned uncooperative - e.g. GST
  - Refocus on distribution, which had wide support (e.g. food security bill), and expansionary fiscal policy to deal with spillover effects of Great Recession
  - Inflation in double digits
  - Growing roadblocks e.g. land acquisition and permissions such as environmental more difficult, exacerbated by new laws and risk averse bureaucracy.

- Course correction on macro-stability started in 2012-13.
  - Government starts fiscal consolidation

- Reinforced by wake up call during taper tantrum in 2013.
  - RBI focused on reducing inflation

Modi I - Macro Reforms



Source: Reserve Bank of India

Inflation Rate based on New CPI introduced from January 2011

- ❑ Approved inflation targeting by RBI
  - RBI undertook a series of reforms including opening up branching and licensing, improving retail electronic payments, and deepening fixed income and derivative markets.
- ❑ Demonetization
  - Misguided in concept, initiated without adequate preparation
  - Damage to informal sector hard to measure
  - Damage to construction and real estate maybe *just desserts* but holds back growth
- ❑ Goods and Services Tax
  - Sound in concept, initiated without adequate preparation, which undercut compliance, constant fiddling creates uncertainty

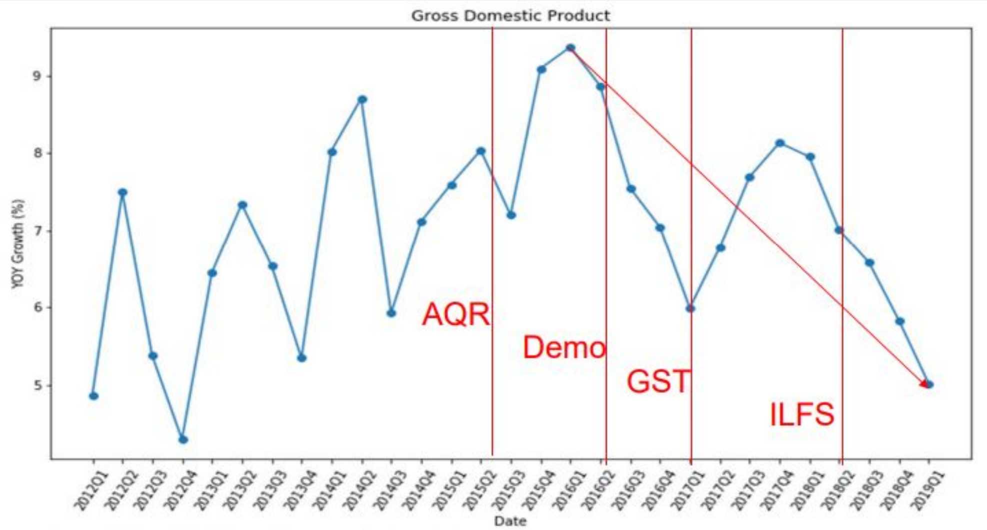
Modi I - Banking and Finance

- Limited efforts including creation of Bank Board Bureau to make public sector appointments
  - Undercut by Finance Ministry from outset

- PSB bank boards have little power and continue to be politicized, banks have limited executive experience and capability in pipeline
  - PSB overstaffing and overpaying at lower levels, underpaying at upper levels and limited capabilities
  - Bank consolidation without any mandate for rightsizing will divert managerial attention and add new bureaucratic battles

- Government mandates continue
  - Mudra loans, MSME forbearance, loan melas

Main Reason of Downfall in GDP in Modi-I



Source: Ministry of Statistics and Programme Implementation

- India is losing its economic way, in part because it is centralizing power without a persuasive economic vision. We risk wasting the demographic dividend and exacerbating internal unrest as joblessness mounts.
- *Minimum government, maximum governance* has been misunderstood. It is about enhancing government efficiency rather than liberalizing and reducing role of government.

Based on constant 2011-12 prices

Why has Modi I not done better?

- ❑ Indeed, significant centralization in Modi I and enhancement of PMO and bureaucratic powers contrasts with significant decentralization in UPA I and II: neither works well.

- ❑ In Modi I & II
  - PMO all powerful and works through bureaucrats
  - Ministers are disempowered for the most part
  - But bureaucrats typically unwilling to take decisions on their own – especially given vigilance actions against past bureaucrats.
  - Everyone looking up for orders but PMO has limited capacity even if it works 24/7

Why has Modi I not done better?

- Strong political vision, less clear what the consistent economic vision is – markets/state, protectionist/open, liberalizing/populist
- Total dependence on top leadership for ideas means periodic *bold actions*, which have not been carefully analyzed or prepared for. These can be problematic.
- Bureaucratic follow-through perforce limited to numerical targets – number of bank accounts opened, number of toilets built, etc. rather than the broader goal of usage and outcomes.
- Desire to attract foreign direct investment, but succumb periodically to unexplained protectionist actions.
- Bottom line: India cannot be *run solely from the top or the center.*

Things which can be done by Government to fight back

- ❑ Deal immediately with stressed sectors.
  - Implement specific reforms to revive the agriculture, power, banking & NBFC sector.
  - Many economists had have solution to revive the stressed sectors. Government should make a committee of them and take suggestions from them.

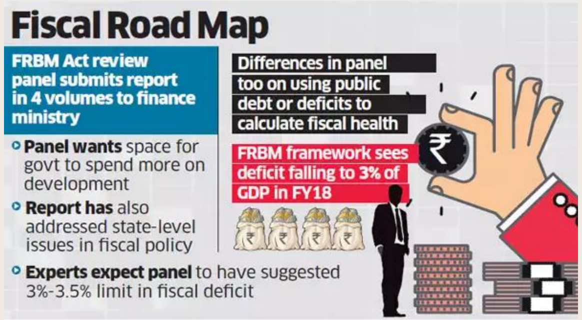
- ❑ Improve functioning of factor markets.

- ❑ Prune some regulations while improving others.

- ❑ Reduce public sector presence.

- ❑ Re-embark on steadily reducing trade barriers and tariffs.

- ❑ Put central and state budgets back on FRBM Review Committee path.



Source: Economic Times

[Note- In May 2016, the government set up a committee under NK Singh to review the FRBM (*Fiscal Responsibility and Budget Management*) Act. The committee recommended that the government should target a fiscal deficit of 3% of the GDP in years up to March 31, 2020 cut it to 2.8% in 2020-21 and to 2.5% by 2023]

Conclusion

- Economic Adversity is a terrible thing to waste. It offers scope for substantial reforms.

- Government is in full majority for to say Modi II have full power in his hand.
  - It can always decentralize more, while strengthening institutions. Unfortunately, there is no pressure on it to do so.
  - It can revitalize growth, and if it does so relying on market forces, these will help further democratize India.

- Political Success of a particular party at that level may divert its attention from the growing economic stress in the country.
  - Without stronger growth, distributive policies, which have been quite effective, will overwhelm revenues, driving the economy into a hard corner.
  - Finance Ministry had have to find the root reason why so many companies are getting closed day by day.
  - Unemployment is at its peak in last 45 year. People are losing their job due to closing of the small small business.

- Government have to take some good step to reach the goal of $5 Trillion Economy
  - Vision is to increase MSMEs contribution to India's GDP to over 50% from the current 29% and that for the Indian economy to scale the $5 trillion mark, the cooperation of the MSME sector will be crucial.

Thank You!